Supreme Court, U.S.
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No. _____

In The

Supreme Court of the United States

CNA HOLDINGS, INC.,
f/k/a HOECHST CELANESE CORPORATION,

Petitioner,

v.

DELAWARE DIRECTOR OF REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of Delaware

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

I. Whether Delaware, consistent with the Commerce Clause and the Due Process Clause, may tax *all* of a nondomiciliary corporation's Federal "recapture" (*i.e.* Delaware Recapture and Foreign (non-Delaware) Recapture) attributable to the sale of a manufacturing plant located in that State, even though (1) the plant was used in an integrated, unitary, multistate business; (2) the corporation's Delaware tax savings due to apportioned depreciation deductions during a twenty-one year period aggregated $118,664; (3) Delaware collected the $118,664 Delaware tax benefit (the Delaware Recapture) and an additional $742,960 of tax on Foreign Recapture attributable to depreciation deductions claimed in 33 other states; (4) the other states also taxed the Foreign Recapture; and (5) Delaware's attempt to tax the Foreign Recapture causes double taxation?

II. Whether Delaware's taxing all of the Foreign Recapture results in unconstitutional discrimination in violation of the Commerce Clause since a company conducting an intrastate business would pay tax on 100% of the Federal "recapture" while a multistate taxpayer would pay tax on nearly 200% of the Federal "recapture?"

LIST OF PARTIES

The petitioner and respondent are as set forth in the caption. In the administrative hearing before the Delaware Tax Appeal Board, the petitioner was referred to as Hoechst Celanese Corporation, and subsequently changed its name to CNA Holdings, Inc.

RULE 29.6 STATEMENT

CNA Holdings, Inc., formerly known as Hoechst Celanese Corporation, is owned by its United States parent, Celanese Americas Corporation, which is owned by Celanese Holding GmbH (Germany), which is owned by Celanese AG (Germany), a publicly traded New York Stock Exchange company.

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PETITION FOR WRIT OF CERTIORARI

CNA Holdings, Inc. ("CNA") respectfully petitions for writ of certiorari to review the judgment of the Supreme Court of Delaware in this case.

OPINIONS BELOW

The Opinion of the Supreme Court of Delaware (App., *infra*, 1a-11a) is officially reported at 818 A.2d 953 (Del. 2003). The opinion of the Superior Court of Delaware, New Castle County, Delaware (App., *infra*, 12a-25a) is not officially reported.

JURISDICTION

The judgment of the Supreme Court of Delaware was entered on March 21, 2003. The jurisdiction of this Court rests on 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution, U.S. Const. art. I, § 8, cl. 3, provides, in relevant part: "The Congress shall have Power . . . [t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."

The Due Process Clause of the Fourteenth Amendment to the United States Constitution, U.S. Const. amend. XIV, § 1, provides, in relevant part: "No State shall

. . . deprive any person of life, liberty, or property, without due process of law."

Relevant portions of the Delaware statutes are set forth at App., *infra*, 37a-40a.

STATEMENT

At issue in this case is the taxation of depreciation recapture. The Delaware Supreme Court decision raises issues of great significance for state taxation of multistate businesses. Delaware's taxation of all "recapture" from the sale of Delaware property used in a unitary, multistate business, attributable to past depreciation deductions claimed in 34 states, offends fundamental principles of fair apportionment. It causes extraterritorial taxation, double taxation and discrimination against multistate taxpayers.

The purpose of depreciation deductions is to allocate the cost of an asset to the various periods and locations which are benefited by that asset. *Hertz Corp. v. United States*, 364 U.S. 122, 126 (1960). Depreciation recapture was introduced in the Federal Internal Revenue Code by the enactment of Sections 1245 and 1250 in 1962 and 1964, respectively, to close what the Treasury Department considered to be a loophole.[1] The loophole arose from Federal income tax situations where (1) the value of the

[1] Section 1245, added by Section 13 of the Revenue Act of 1962 (P.L. 87-834). Section 1250, added by Section 231(a) of the Revenue Act of 1964 (P.L. 88-272).

asset had not dropped, (2) depreciation deductions had offset ordinary income and (3) gain from the later sale of the asset was taxed at capital gain rates. Section 1245, applicable to personal property, and Section 1250, applicable to real property, were designed to close the loophole by "recapturing" and treating the gain attributable to past depreciation deductions as ordinary income rather than as capital gain. *See* S. Rep. No. 88-830, at 131-39 (1964).

"Matching income with expenses is a fundamental component of federal income taxation." (App., *infra*, 73a) (KPMG Report.) The dispute in this case centers on Delaware's deviation from this principle, whereby Delaware (A) only allowed "apportioned" depreciation deductions and (B) taxed 100% of the "recapture" attributable to depreciation deductions taken on tax returns filed in 33 other states.

The Court has stated that "the income attributed to [a] State for tax purposes must be rationally related to 'values connected with the taxing State.'" *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 273 (1978) (citing *Norfolk & Western Ry. v. Missouri State Tax Comm'n*, 390 U.S. 317, 325 (1968)). Delaware's taxation of Foreign Recapture attributable to depreciation deductions taken in 33 other states is akin to New Mexico's unsuccessful attempt to tax "gross-up" amounts that are "deemed" to be received for purposes of calculating a corporation's Federal foreign tax credit, *F.W. Woolworth Co. v. Taxation & Revenue Department of New Mexico*, 458 U.S. 354 (1982), in the sense that both items involve tax benefits related to the conduct of business in other taxing jurisdictions. This Court noted "even the Supreme Court of New Mexico recognized as 'fictitious'" the "'gross-up'" which New Mexico attempted to tax. *Id.* at 372 (citation omitted). Such "fictitious"

income was not allowed to be taxed in that case. Recapture attributable to depreciation deductions taken in other states should not be allowed to be taxed here.

Since "recapture" recovers depreciation deductions that were not needed, it follows that a state tax collector cannot recapture a tax deduction which had not been claimed in that state. The Federal Government would certainly never attempt to recapture depreciation deductions granted by Canada or Mexico. Why should Delaware recapture depreciation deductions granted by other states?

A. Petitioner's Business

The facts in this case are not in dispute. CNA Holdings, Inc. is a corporation with its principal place of business in New Jersey. (App., *infra*, 13a.) CNA manufactures and sells a diversified line of chemicals, fibers and specialty products.

From 1968 to 1989, CNA owned and operated a PVC manufacturing plant (the "Plant") in New Castle, Delaware, as part of an integrated, unitary, manufacturing business. During this period, CNA filed income tax returns in 34 states, including Delaware. (App., *infra*, 2a, 13a-15a, 42a-45a.) In apportioning its net income, CNA received a pro-rata state tax benefit from the annual depreciation deductions taken in each state in which it filed an income tax return, including Delaware. Depreciation deductions on the Plant were claimed in all 34 states, including $1,363,951 deducted in Delaware. CNA's total tax benefit of the depreciation deductions taken in Delaware was $118,664. (App., *infra*, 16a, 29a.)

B. Sale of the Plant

In 1989, CNA sold the Plant to an unrelated party. (App., *infra*, 42a.) In computing Federal taxable income, CNA included the income from the sale of the Plant. This income included two parts: (1) capital gain of $4,100,751, and (2) ordinary income from the "recapture" of previously allowed depreciation of $9,903,729. Thus, the total income for Federal income tax purposes was $14,004,480. (App., *infra*, 14a, 43a.)

C. Delaware's Taxing Scheme

Delaware imposes an income tax measured by net income on corporations doing business in Delaware. Del. Code tit. 30, § 1902.

For corporations such as CNA, which engage in business in multiple states, specified items of income are first allocated in their entirety within and without Delaware according to their source. The remainder is apportioned by a statutory formula. Del. Code tit. 30, § 1903. The determination of whether an item of income is allocable to a single state or apportionable to multiple states is dependent upon the type of income, not on the nature of the income, *i.e.*, business income or investment income. Gains or losses from the sale of real property and depreciable tangible personal property, such as the Plant at issue here, are allocated to the state in which the property is located. Del. Code tit. 30, § 1903(b)(3) and (4).

D. CNA's Claim for Refund

CNA's original Delaware income tax return reported tax liability in the amount of $1,224,075, of which $1,218,390 was attributable to allocating to Delaware all of the income (*i.e.*, the $9,903,729 depreciation recapture and the $4,100,751 capital gain) derived from the sale of the Plant. (App., *infra*, 27a, 28a.) The Delaware tax on the sale of the Plant consisted of $356,766 on the capital gain and $861,624 on the recapture of depreciation. (App., *infra*, 44a.)

In December, 1992, CNA timely filed an amended Corporation Income Tax return (Delaware Form 1100) and claim for refund in which it subtracted the depreciation recapture from its income allocated in full to Delaware and included only an apportioned share of such income on its amended income tax return. CNA did not dispute the direct allocation of the capital gain portion of the income from the sale of the Plant. CNA also included in its Delaware apportionable income $35,339,269 in depreciation recapture from sales of plants in Texas and Louisiana. The $35,339,269 had been allocated entirely outside of the State on the original return. The total amount of depreciation recapture reclassified as apportionable income on the amended return was $45,242,998 (*i.e.* $35,339,269 from the sale of the plants in Texas and Louisiana, plus $9,903,729 from the sale of the Plant). (App., *infra*, 44a.) Based on these changes in the computation of its Delaware corporate income tax, CNA claimed a refund of $817,166 on the amended return. (App., *infra*, 3a.)

Throughout the period that CNA owned the Plant, CNA filed income tax returns in 34 states and apportioned between 82% and 95.6% of its operating income to states

other than Delaware. CNA apportioned the depreciation recapture to the other 33 states where it engaged in business and paid state taxes on such depreciation recapture. (App., *infra*, 45a.)

E. The Proceedings Below

The Director of Revenue ("Director") denied CNA's claim for refund, and CNA protested the Director's denial. (App., *infra*, 3a.) In January, 1993, the Director issued a Notice of Determination denying CNA's protest of the Director's prior denial of the refund claim. (App., *infra*, 41a.) Thereafter, CNA filed a petition with the Delaware Tax Appeal Board, which issued its decision denying CNA's petition in February, 2001. (App., *infra*, 26a-35a.) Thereafter, CNA filed suit with the Superior Court of Delaware.

(a) The Superior Court. In January, 2002, the Superior Court of Delaware, New Castle County, reversed the Tax Appeal Board and upheld CNA's refund claim. (App., *infra*, 12a-25a.) The court reached this result on statutory interpretation grounds. Concluding that the term "gains" as used in section 1903(b)(3)[2] does not, as a matter of statutory interpretation, include the recovery of depreciation deductions on the Plant that were allowed by other states, the court noted that Delaware's method of allocating the gain from the sale of the Plant "is out of step with the rest of the country." (App., *infra*, 21a, 22a.) Citing the principle that "[a] taxing statute may not be sustained

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[2] "Gains and losses from the sale or other disposition of real property shall be allocated to the state in which the property is . . . located . . . ."

if it operates 'unreasonably or arbitrarily . . . in attributing to [a state] a percentage of income out of all appropriate proportion to the business transacted by the appellant in that state,'" (App., *infra*, 22a-23a) (citing *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135 (1931)), the court determined that "taxation of 187% of the proceeds of the sale of the PVC plant because of the almost double taxation of the recapture component of the gain on the sale of the property constitutes an unreasonable result." (App., *infra*, 23a.) In view of the court's interpretation of the statute, the court did not address CNA's constitutional challenge to the statute. (App., *infra*, 10a.)

(b) The Delaware Supreme Court. On appeal, the Supreme Court of Delaware reversed the decision of the lower court (App., *infra*, 1a-11a) and held that "the statute clearly and unambiguously requires that the entire gain be included in the taxpayer's Delaware taxable income" (App., *infra*, 2a), that "§ 1903 does not cause unreasonable results" and that "CNA's Delaware tax is [not] out of all proportion to its business activities in Delaware." (App., *infra*, 10a.)

The court acknowledged that "[t]he inevitable result of Delaware's tax scheme is that, when Delaware real property is sold, the corporation suffers double taxation on that transaction. Delaware taxes 100% of the gain, and almost all other states tax their allocated share of the same gain. In this case, the result was that 187% of the gain was taxed. . . . " (App., *infra*, 5a.) Despite this clear Commerce Clause violation, the court justified the inevitable double taxation that occurs in this situation:

> [A]lthough Delaware taxes 100% of the gain from the sale of Delaware property, it does not tax any portion of the gain from the sale of out-of-state property. Thus, to the extent that Delaware may be deemed to be taking more than its share of the tax on a Delaware property sale, it is taking less than its share of the tax on out-of-state transactions.

(App., *infra*, 2a.)

REASONS FOR GRANTING THE PETITION

The decision of the Delaware Supreme Court sustaining Delaware's taxation of 100% of the Foreign Recapture, on the theory that an unconstitutional tax is allowable if a different constitutional tax is not collected, is irreconcilable with controlling decisions of this Court and warrants review for four compelling reasons. First, by sustaining the taxation of all of the recapture on the sale of a Delaware Plant even though other states in which depreciation deductions were taken also taxed an apportioned share of the recapture they were entitled to, the lower court's holding permits Delaware to engage in discriminatory, extraterritorial taxation in contravention of the Due Process and Commerce Clauses and decisions of this Court.

Second, review of the decision below will enable this Court to resolve a clear conflict among state court decisions as to whether a state in which business property is located may tax in full recapture from the sale of property used in a multistate, unitary business. *See Hercules Inc. v. South Carolina Tax Comm'n*, 304 S.E.2d 815 (S.C. 1983), *overruled on other grounds by Rose v. Thrash*, 354

S.E.2d 378 (S.C. 1987). Third, although in a corporate income tax context this Court has alluded to the prohibition on a state to tax all income where an apportioned share of that income is taxed in another state, *see Mobil Oil Corp. v. Commissioner of Taxes of Vermont*, 445 U.S. 425, 444-45 (1980), this principle has not been specifically applied to the corporation income tax. This case presents that opportunity.

Fourth, the decision below poses a serious threat to constitutional restraints on state taxation by allowing a state to tax value earned outside its borders, in violation of the Due Process and Commerce Clauses. Allowing this decision to stand invites other states to enact similar schemes to tax extraterritorial income.

I.

THE DELAWARE COURT'S DECISION CONDONING MULTIPLE TAXATION RESULTING FROM DELAWARE'S TAXING SCHEME CANNOT BE RECONCILED WITH THIS COURT'S STATE TAX JURISPRUDENCE

To survive scrutiny under the Commerce Clause, a challenged tax must: (1) be applied to an activity with a substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to the services provided by the state. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The application of Delaware's tax scheme to the income derived from CNA's sale of the Plant fails the second and third prongs of the four-part test.

A. The Requirements of Fair Apportionment

The Commerce Clause and the Due Process Clause prohibit states from taxing value earned outside their borders. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 164 (1983). Taxing the recapture of depreciation deductions granted by other states is a clear violation of this principle.

A tax must be "fairly apportioned" to the taxpayer's activities in the taxing state, to prevent multiple taxation and extraterritorial taxation. The "central purpose behind the apportionment requirement is to ensure that each State taxes only its fair share of an interstate transaction." *Goldberg v. Sweet*, 488 U.S. 252, 260-61 (1989).

An objecting taxpayer will be successful in striking down a tax if it demonstrates by clear and cogent evidence that the income attributed to the state either is "out of all appropriate proportion to the business transacted by the [taxpayer] in that state," *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135-36 (1931), has "led to a grossly distorted result" for the taxpayer, *Norfolk & Western Railway v. Missouri State Tax Commission*, 390 U.S. 317, 326 (1968), or is "'inherently arbitrary'" or "'produced an unreasonable result,'" *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 274 (1978) (citing *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920)).

B. Delaware's Taxation of the Entire Recapture Violates the External Consistency Test

Fairness requires an apportionment system to be both internally and externally consistent. *Container Corp.*, 463 U.S. at 169. External consistency, the aspect of fair

apportionment relevant to this case, focuses on the "economic justification for the State's claim upon the value taxed, to discover whether a State's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995).

The external consistency test asks whether a State taxed only that "portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262. External consistency looks to the economic justification for the state's claim upon the value being taxed in order to discover whether a state is taxing economic activity that occurred in other jurisdictions. *See Jefferson Lines*, 514 U.S. at 185.

There is no "economic justification" for Delaware's taxation of 100% of the Foreign Recapture because CNA's depreciation deductions claimed in Delaware during the Plant's existence represented a small fraction of the depreciation deductions claimed in all states where CNA conducted business, and CNA paid taxes in those states on an apportioned share of the depreciation recapture. "Formulary apportionment, unlike specific allocation, recognizes that because the plant is part of the taxpayer's integrated manufacturing operation, its income is not attributable only to activities taking place in Delaware." (App., *infra*, 58a) (Declaration of expert witness, Professor Richard D. Pomp.) The income of a multistate corporate enterprise arises from the "operation of the business as a whole [and] it [is] misleading to characterize the income of the business as having a single identifiable 'source.'" *Mobil Oil Corp. v. Commissioner of Taxes of Vt.*, 445 U.S. 425, 438 (1980).

Delaware's tax upon the entire Foreign Recapture, when other states in which CNA conducted business also taxed an apportioned share of the recapture relating to depreciation deductions claimed in those states, is unfair and unreasonable in that it does not bear the required "'rational relationship between the income attributed to the State and the intrastate values'" of the business being taxed. *Hunt-Wesson, Inc. v. Franchise Tax Bd. of Calif.*, 528 U.S. 458, 464 (2000) (citation omitted). Indeed, Delaware's failure to apportion any part of the Federal Recapture, which is acknowledged to be unitary income subject to apportionment, leads inevitably to malapportionment and multiple taxation.

C. Delaware's Taxation of the Foreign Recapture Results in Multiple Taxation

The court below conceded that "[t]he inevitable result of Delaware's tax scheme is that, when Delaware real property is sold, the corporation suffers double taxation on that transaction. Delaware taxes 100% of the gain, and almost all other states tax their allocated share of the same gain. In this case, the result was that 187% of the gain was taxed. . . . " (App., *infra*, 5a.) The Delaware Supreme Court justified such double taxation by reasoning that, "to the extent that Delaware may be deemed to be taking more than its share of the tax on a Delaware property sale, it is taking less than its share of the tax on out-of-state transactions." (App., *infra*, 2a.) The Court is saying that it is all right for Delaware to tax income that it is not allowed to tax because it does not tax other income that it is allowed to tax. This reasoning is suspect. This Court has made it clear that a discriminatory overreaching in one part of a taxing statute cannot be cured by an

underreaching in another part. *See Associated Indus. of Mo. v. Lohman*, 511 U.S. 641 (1994).

The presence in Delaware of property used in an integrated manufacturing business does not mean the taxation of 100% of the recapture "is fairly attributable to economic activity within [Delaware]." *Jefferson Lines*, 514 U.S. at 185. After all, on the deduction side, Delaware did not allow 100% of the Plant's depreciation deductions. Delaware only allowed an apportioned share. Therefore, an unapportioned tax on the recapture cannot be justified on the basis that the Delaware situs of the property provides a sufficient "local activity" so that apportionment is not required. *See Central Greyhound Lines, Inc. v. Mealey*, 334 U.S. 653, 661-64 (1948). The Plant was not a discrete investment divorced from the rest of its business. The Plant was an active part of an integrated, multistate manufacturing business.

The taxpayer in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 187 (1983), argued that California's taxation of the apportioned income of domestic and foreign subsidiaries engaged in the same line of business resulted in double taxation due to the "divergence in the taxing schemes adopted by California and the foreign taxing authorities." Noting the similarity between that case and *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), this Court distinguished the multiple taxation condemned in *Japan Line,* because the double taxation in *Container Corp.*, "although real, is not the 'inevitabl[e]' result of the California taxing scheme." *Container Corp.*, 463 U.S. at 188 (citation omitted). The multiple taxation in *Container Corp.* was not "inevitable" because it resulted from two different methods of dividing the tax base, formulary apportionment by California and

separate accounting by other countries. In *Japan Line* and this case, by contrast, there was no effort to divide the tax base. "In *Japan Line*, we relied strongly on the fact that one taxing jurisdiction claimed the right to tax a given value in full, and another taxing jurisdiction claimed the right to tax the same entity in part. . . . " 463 U.S. at 188. Similarly, Delaware allocated 100% of the recapture to itself and 33 other states taxed an apportioned share of the recapture. As in *Japan Line*, the multiple taxation here is real and inevitable.

"If [a State's] method of formula apportionment 'inevitably' led to double taxation, . . . that might be reason enough to render it suspect." *Container Corp.*, 463 U.S. at 193 (citation omitted). Prohibited double taxation is precisely what occurred here and will inevitably occur whenever a multistate taxpayer, such as CNA, derives income from the sale of business property located in Delaware.

II.

STATE COURTS THAT HAVE CONSIDERED SIMILAR GEOGRAPHIC ALLOCATION PROVISIONS ARE IN CONFLICT

Provisions similar to Delaware's geographic allocation of income or loss derived from the sale of real or tangible personal property have been challenged in South Carolina and Ohio.

In *Hercules Inc. v. South Carolina Tax Commission*, 304 S.E.2d 815 (S.C. 1983), *overruled on other grounds by Rose v. Thrash*, 354 S.E.2d 378 (S.C. 1987), Hercules Inc. challenged the taxation of the entire gain from the sale of a South Carolina plant under a statute similar to

Delaware's (section 12-7-1120(4), Code of South Carolina (1976)), which required the geographic allocation of gain or loss from sales of real property. The South Carolina Supreme Court took a position that conflicts with the decision of the Delaware Supreme Court below, refusing to allocate to South Carolina the entire recaptured depreciation on the plant.

> [T]he Tax Commission allowed Hercules . . . to apportion depreciation of the plant for income tax purposes throughout the many states in which it does business. This caused South Carolina to receive greater income tax revenue from Hercules during this period of time than would have been received had all the depreciation been allocated to South Carolina. Further, other states having allowed Hercules a tax deduction for this apportioned depreciation, are entitled to recapture this depreciation upon the sale of the plant.
>
> If we were to hold that [the tax law] allows South Carolina the sole benefit of recapturing all of the depreciation taken, one of two gross inequities would result. Either all other states which allowed depreciation would be denied the right to recapture or Hercules would be subjected to double taxation.[3]

Id. at 818.

In contrast, the Ohio Supreme Court construed a similar provision (section 5733.051(C) of the Ohio Revised

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[3] The South Carolina Supreme Court's holding that recapture income must be apportioned, not allocated, was codified in section 12-6-2220(4), Code of South Carolina (1995).

Code)[4], providing for geographic allocation of the gain or loss from the sale of real property, to require 100% of the recapture income to be allocated to Ohio, the situs of the property. *Harsco Corp. v. Tracy*, 708 N.E.2d 1000 (Ohio 1999). Acknowledging that the taxpayer "has set forth a compelling argument concerning the fairness of proportional allocation," *id.* at 1003, the court found no statutory support to apportion recaptured depreciation "based on the amount of the deductions benefiting the taxpayer accumulated over the time of the ownership." *Id.* at 1002. The court disposed of the taxpayer's Commerce Clause argument as follows: "the income sought to be allocated is not interstate income; it is income that can be identified as earned in Ohio. . . . If income is earned totally within a state and allocated to the state, then there can be no violation of *Complete Auto*." *Id.* at 1003-04.

The Ohio court's response to the taxpayer's Commerce Clause objections wrongly assumes that the situs of property provides a sufficient local incident to impose an unapportioned tax derived therefrom, despite its use in a unitary business, and disregards this Court's teaching that the income of an integrated multistate business cannot be clearly identified on a geographic basis. Despite the fact that "the discrete components of a state income tax may appear in isolation susceptible of geographic designation,. . . . we have recognized the impractibility of

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[4] "Capital gains and losses from the sale or other disposition of real property located in this state are allocable to this state."

Section 5733.051(D) of the Ohio Revised Code, provides, in relevant part, that "[c]apital gains and losses from the sale or other disposition of tangible personal property are allocable to this state if the property had a situs in this state."

assuming that all income can be assigned to a single source." *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 378 (1991).

To justify the double taxation that inevitably results from the taxation of the entire recapture of depreciation from the sale of an instate plant or other facility used in a unitary business, the Delaware and Ohio courts have disregarded bedrock constitutional principles.

The Pennsylvania Supreme Court recently applied these principles when it invalidated the City of Philadelphia's imposition of its Business Privilege (gross receipts) Tax upon 100% of the media receipts derived by the Philadelphia Eagles football team for the broadcast of its football games, half of which were played outside Philadelphia, as a violation of the external consistency test, because it taxed business activity that occurred in other taxing jurisdictions. *Philadelphia Eagles Football Club, Inc. v. City of Philadelphia*, Nos. 14 & 15 EAP 2001, 2003 Pa. LEXIS 669 (Pa. Apr. 25, 2003).

The court rejected the City's assertion that taxing 100% of its receipts from broadcasting games was proper because the taxpayer maintained its principal place of business in Philadelphia and played half its games there. The court concluded that the 100% discrepancy between the tax assessed by the City and the tax due if apportioned is constitutionally unacceptable. "The City's levy of 100% of the Football Club's media receipts, . . . was inherently arbitrary and had no rational relationship to the Football Club's business activity that occurred in Philadelphia." 2003 Pa. LEXIS 669, at *57.

The conflict among the states creates uncertainty on the important issue of the proper method of dividing

income derived in a unitary business. This Court needs to resolve this issue.

III.

THIS COURT'S CONTROLLING COMMERCE CLAUSE DECISIONS PROHIBIT DELAWARE'S TAXATION BY ALLOCATION OF INCOME DERIVED FROM PROPERTY USED IN A UNITARY BUSINESS WHEN SUCH INCOME IS TAXED ON AN APPORTIONED BASIS IN OTHER STATES

This Court long has held that a taxing scheme will offend the Commerce Clause if it exposes interstate business to multiple taxation of income. *See Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256 (1938), where the Supreme Court observed "without the protection of the commerce clause [interstate commerce] would bear cumulative burdens not imposed on local commerce." Multiple taxation "is threatened whenever one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 184-85 (1995).

That is precisely what occurred when Delaware taxed the entire Foreign Recapture. The court below conceded that "[t]he inevitable result of Delaware's tax scheme is that, when Delaware real property is sold, the corporation suffers double taxation on that transaction." (App., *infra*, 5a.) The resulting double taxation contravenes a paramount principle of Commerce Clause jurisprudence. "The rule which permits taxation by two or more states on an

apportionment basis precludes taxation of all of the property by the state of the domicile. Otherwise there would be multiple taxation of interstate operations and the tax would have no relation to the opportunities, benefits, or protection which the taxing state gives those operations." *Standard Oil Co. v. Peck*, 342 U.S. 382, 384-85 (1952) (citation omitted).

Japan Line, Ltd. v. County of Los Angeles, 441 U.S. 434 (1979), involved an attempt to impose a fairly apportioned *ad valorem* property tax on cargo containers which were temporarily located in various California ports, when the same containers were subject to an unapportioned property tax in their home port of Japan. In striking down the California property tax, this Court declared: "It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause. . . . The corollary of the apportionment principle, . . . is that no jurisdiction may tax the instrumentality in full." *Id.* at 446-47 (citations omitted).

Although these cases involved property tax levies, a state is forbidden to impose an income tax upon all income where another state may tax an apportioned share of that income. This Court has stated:

> [W]e may assume, . . . that the State of commercial domicile has the authority to lay some tax on . . . dividend income. . . . But there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method.

Mobil Oil Corp. v. Commissioner of Taxes of Vt., 445 U.S. 425, 445-46 (1980).

> Taxation by apportionment and taxation by allocation to a single situs are theoretically incommensurate. . . .

Id. at 444.

Delaware's tax scheme suffers from precisely the same constitutional infirmity and, as stated in a state tax treatise frequently cited by this Court, it "cannot be reconciled with the Court's existing Commerce Clause doctrine that bars a state from taxing a taxpayer's unapportioned tax base when the taxpayer is taxable in another state in order to protect a taxpayer from the risk of multiple taxation." I Jerome R. Hellerstein & Walter Hellerstein, *State Taxation*, ¶8.02[3], at 8-18 (3d ed. 2001).

If the Delaware court decision is allowed to stand, it will create confusion and uncertainty as to whether this Court's teaching regarding property taxation – that taxation by apportionment by one or more states precludes taxation by allocation to a single situs – applies to income taxation. If left undisturbed, it will embolden states to tax extraterritorial income by enacting similar tax schemes which depart from the widely accepted formulary apportionment method. Such schemes seriously undermine the unitary business principle which, "[b]ecause of the complications and uncertainties in allocating the income of multistate businesses to the several States," *Allied-Signal, Inc. v. Director, Division of Taxation*, 304 U.S. 768, 778 (1992), repeatedly has been approved by this Court.

CONCLUSION

For the reasons set forth above, the petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX A

IN THE SUPREME COURT OF
THE STATE OF DELAWARE

DIRECTOR OF REVENUE, Appellee Below, Appellant, v. CNA HOLDINGS, INC., F/K/A HOECHST CELANESE CORPORATION, Appellant Below, Appellee.	§ § § § § § § § § § §	No. 51, 2002 Court Below: Superior Court of the State of Delaware in and for New Castle County C.A. No. 01A-03-001

Submitted: December 3, 2002
Decided: March 21, 2003

Before **VEASEY**, Chief Justice, **WALSH, HOLLAND, BERGER** and **STEELE**, Justices, constituting the Court *en Banc*.

Upon appeal from the Superior Court. **REVERSED** and **REMANDED**.

Joseph Patrick Hurley, Jr., Esquire, of the Department of Justice, Wilmington, Delaware, for Appellant.

Stanford L. Stevenson, III, Esquire, of Morris, Nichols, Arsht & Tunnell, Wilmington, Delaware, and Paul H. Frankel, Esquire, and Michael A. Pearl, Esquire, of Morrison & Foerster, LLP, New York, New York, for Appellee.

BERGER, Justice:

In this appeal, we consider the meaning of a tax statute that allocates and apportions to Delaware part of

the entire taxable income of corporations that generate revenue in several states. The relevant provision includes, as taxable income in Delaware, 100% of the gains (or losses) on the sale of real property located in this State. This statute caused the appellee taxpayer to pay tax on 187% of its gain on the sale of a Delaware property, since other states also taxed the transaction. The Delaware Tax Appeal Board rejected the taxpayer's claim for a refund, but the Superior Court reversed, holding that a literal reading of the statute leads to an unreasonable result – almost double taxation. We hold that the statute clearly and unambiguously requires that the entire gain be included in the taxpayer's Delaware taxable income. The Delaware tax is not unreasonable because, although Delaware taxes 100% of the gain from the sale of Delaware property, it does not tax any portion of the gain from the sale of out-of-state property. Thus, to the extent that Delaware may be deemed to be taking more than its share of the tax on a Delaware property sale, it is taking less than its share of the tax on out-of-state transactions.

Factual and Procedural Background

CNA Holdings, Inc., formerly known as Hoechst Celanese Corporation, operates a multi-state manufacturing operation and, during the time period in question, it filed state income tax returns in 34 jurisdictions, including Delaware. In 1989, CNA sold its PVC Film Division Plant, which was located in New Castle, Delaware, for approximately $26 million. For federal income tax purposes, CNA recognized a gain in the amount of $14,004,480 from the sale of the PVC plant. That gain included $9,903,729 in depreciation recapture. The remainder, $4,100,751, was what CNA calls "economic gain."

CNA's federal adjusted gross income for 1989 was $120,384,436. It originally paid $1,224,075 in Delaware income tax. Of that amount, $1,218,390 represented the tax on the PVC plant sale. CNA also paid a total of $649,030 in other state taxes on the gain from the PVC plant sale. In 1992, CNA filed an amended Delaware tax return seeking a refund of $817,166. The amendment removed the $9.9 million in depreciation recapture on the PVC plant sale from non-apportionable income within Delaware, and added it to apportionable income. The amendment also moved $35.3 million in depreciation recapture from other, out-of-state, transactions from non-apportionable to apportionable income.

The Delaware Director of Revenue denied CNA's claim for a refund and, after conducting a hearing, the Delaware Tax Appeal Board also ruled against CNA. The Superior Court reversed, based on its conclusion that "a literal reading of the statute [30 *Del. C.* § 1903(b)(3)] would lead to an unreasonable . . . result." To avoid an unreasonable result, the trial court interpreted the word "gains" to mean only "economic gains" and not depreciation recapture. This appeal followed.

Discussion

There are two federal constitutional limitations on a state's power to tax income from a multi-state business:

> First, no tax may be imposed, unless there is some minimal connection between [the business] activities and the taxing State. . . . Second, the

> income attributed to the State for tax purposes must be rationally related to "values connected with the taxing State."[1]

Because it is difficult to determine precisely how much of a corporation's income is generated in each state, the method of apportioning income in this, or any other, state, "will only be disturbed when the taxpayer has proved by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportion to the business transacted . . . in that State' . . . or has 'led to a grossly distorted result. . . .'"[2]

Delaware's allocation and apportionment statute, 30 *Del.C.* § 1903(b), differs from the apportionment statutes of almost all other states. In Delaware, first income is allocated to the state in which the asset is located. Thus, for example, patent royalties are allocated to the states in which the patented process or product is manufactured or used, and gains (or losses) from the sale of real property and depreciable tangible personal property are allocated to the state in which the property is located.[3] The remainder of the corporation's net income is apportioned to Delaware based on Delaware's percentage of the company's total asset values, wages, and gross receipts.[4] The parties agree that most other states apportion all business income based on a formula like the one used in Delaware, and only

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[1] *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267, 273 (1978) (Citations omitted).

[2] *Id.* at 274 (Citations omitted).

[3] 30 *Del.C.* § 1903(b)(2),(3), & (4).

[4] 30 *Del.C.* § 1903(b)(6).

allocate non-business income according to geographic rules.

The inevitable result of Delaware's tax scheme is that, when Delaware real property is sold, the corporation suffers double taxation on that transaction. Delaware taxes 100% of the gain, and almost all other states tax their allocated share of the same gain. In this case, the result was that 187% of the gain was taxed and CNA paid, to all states in which it pays taxes, a total of $1,867,420 on its $14,004,480 gain, or approximately 13% in state taxes. But the issue is not whether a particular item is arguably overtaxed; the issue is whether the Delaware statute unambiguously provides for 100% taxation on the gain from the sale of Delaware real estate. If so, we must decide whether application of the Delaware statute leads to a grossly distorted result, out of all proportion to the business CNA transacted in Delaware.

The Superior Court only reached the first issue, finding that a literal reading of the statute leads to an unreasonable result. The problem with the trial court's analysis is that it failed to consider the entire statutory allocation scheme. Section 1903(b) provides, in relevant part:

> (b) "Taxable income" subject to taxation under this chapter means the portion of the entire net income of a corporation which is allocated and apportioned to this State in accordance with the following provisions:
>
> (1) Rents and royalties . . . from tangible property shall be allocated to the state in which the property is physically located;

(2) Patent and copyright royalties . . . shall be allocated proportionately to the states in which the product or process protected by the patent is manufactured or used or in which the publication protected by the copyright is produced or printed;

(3) Gains and losses from the sale or other disposition of real property shall be allocated to the state in which the property . . . is physically located;

(4) Gains and losses from the sale or other disposition of tangible property for which an allowance for depreciation is permitted for federal income tax purposes . . . shall be allocated to the state where the property is physically located or is normally used in the taxpayer's business;

(5) Interest . . . to the extent included in determining entire net income . . . shall be allocated to the state where the transaction took place which resulted in the creation of the obligation with respect to which the interest was earned;

(6) If the entire business of the corporation is transacted or conducted within this State, the remainder of its entire net income shall be allocated to this State. If the business . . . is transacted . . . in part without this State, such remainder . . . shall be apportioned to this State on the basis of the ratio obtained by taking the arithmetical average of these 3 ratios:

a. The average of the value . . . of all the real and tangible personal property, owned or rented, in this State . . .

> expressed as a percentage of the average of the value . . . of all such property of the taxpayer . . . ;
>
> b. Wages, salaries and other compensation paid . . . to employees within this State . . . expressed as a percentage of all such wages, salaries and other compensation . . . ;
>
> c. Gross receipts from sales of tangible personal property physically delivered within this State . . . and gross income from other sources within this State . . . expressed as a percentage of all such gross receipts . . . and gross income. . . .

CNA's amended return relates only to taxes paid under subsections (3) and (4), resulting from the sale of its Delaware PVC plant and equipment. CNA argues, and the trial court agreed, that the word "gains" in both subsections should be interpreted to mean gains other than amounts attributable to depreciation recapture.

The goal of statutory construction is to "ascertain and give effect to the intent of the legislature."[5] "If a statute is unambiguous, there is no need for judicial interpretation, and the plain meaning of the statutory language controls."[6] Generally, a statute is considered ambiguous if it is reasonably susceptible of two interpretations. "Ambiguity may also be found if a literal reading of the statute would

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[5] *Ingram v. Thorpe,* 747 A.2d 545, 547 (Del. 2000).

[6] *Eliason v. Englehart,* 733 A.2d 944, 946 (Del. 1999).

lead to an unreasonable or absurd result not contemplated by the legislature."[7]

The word "gains," as used in § 1903, is not subject to two reasonable interpretations. Delaware's corporation income tax is based on the corporation's federal taxable income. Section 1903 includes numerous references to the Internal Revenue Code in identifying those items from the taxpayer's federal taxable income that must be included in "entire net income" for Delaware state tax purposes. The word "gains" is not defined in § 1903. Since the Delaware corporation tax "piggybacks" on the federal corporation tax, however, it follows that the definition of "gains" for Delaware tax purposes is the same as the definition of "gains" for federal tax purposes. The parties agree that, for federal tax purposes, "gains" includes both "economic gain" and depreciation recapture.

Even though the language of the statute is plain and unambiguous, we must decide whether a literal reading of § 1903 leads to unreasonable results. As noted, the trial court considered only the 187% taxation of the PVC gain and found that to be unreasonable. But the statute does not operate in parts. Section 1903 allocates and apportions *all* of a corporation's federal taxable income. Thus, to decide whether § 1903 imposes an unreasonable tax burden on CNA, we must consider the percentage of its income that is taxed in Delaware as compared with the percentage of CNA's income that is generated in or attributable to Delaware.

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[7] *Newtowne Village Service Corp. v. Newtowne Road Development Company, Inc.*, 772 A.2d 172, 175 (Del. 2001).

This record establishes that, in 1989, Delaware taxed 11.6% of CNA's federal taxable income. If CNA's amended return were accepted, Delaware would be taxing 3.88% of CNA's federal taxable income. CNA did not present evidence as to the amount of income actually attributable to Delaware. Rather, CNA pointed out that, under the § 1903(b)(6) apportionment formula, Delaware taxed 1.12% of its apportionable income in 1989. CNA also relied on its experts' opinions that the apportionment formula correctly approximates the amount of income attributable to Delaware and that Delaware's allocation provisions create unreasonable results.

CNA's evidence establishes that Delaware's tax structure clashes with that of most other states and that, on this transaction, CNA was required to pay tax on 187% of its gain. Those facts, however, do not establish that, by giving the word "gains" in § 1903 its plain meaning, the statute as a whole yields unreasonable results. In fact, depending on how one reviews the numbers, CNA is paying less than its fair share of state taxes. Over the years that it owned the PVC plant, CNA took a total of $31,582,830 in depreciation on the plant. In Delaware, that deduction amounted to $118,664 in tax savings and, when added to the savings in all other states, CNA's total tax benefit was $1,964,460. The total tax that CNA paid on the recapture of that depreciation (including full payment of the Delaware tax) was $1,510,654. Thus, CNA actually wound up with a net benefit of $453,806.

Moreover, the Delaware tax structure allocates 100% of the gains on out-of-state transactions to the state in which the property was located. In 1989, alone, CNA recognized $77.9 million in taxable income that was allocated to states other than Delaware, which included

$63.5 million in gains on the sale of depreciable property outside Delaware. None of those amounts were included in the original tax calculation for 1989 and there is no reason to believe that similar gains in other years were included in Delaware taxable income.

In sum, we cannot conclude from this record that § 1903 allocates a disproportionate share of CNA's total income to Delaware. To the contrary, it appears that the overall impact of the Delaware corporation tax structure is beneficial to the multi-state taxpayer. As the Director of Revenue testified, in 1989 Delaware taxed approximately $25 million in gains on the sale of Delaware property and failed to tax approximately $5.7 billion in gains on the sale of out-of-state property. Given that disparity, the Director was of the view that Delaware taxes less than it could permissibly tax under an apportionment tax structure.

Our conclusion that § 1903 does not cause unreasonable results also resolves the two issues that the Superior Court did not reach. First, CNA has not met its burden of proof in challenging the constitutionality of the statute, as there has been no showing that CNA's Delaware tax is out of all proportion to its business activities in Delaware. For the same reason, we find no abuse of discretion in the Director of Revenue's refusal to adjust CNA's taxable income to correct any unfairness.[8]

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[8] 30 *Del.C.* § 1903(c).

Conclusion

Based on the foregoing, the decision of the Superior Court is reversed and the decision of the Tax Appeal Board is reinstated. This matter is remanded to the Superior Court for further action in accordance with this opinion. Jurisdiction is not retained.

APPENDIX B

IN THE SUPERIOR COURT OF THE
STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

CNA HOLDINGS, INC., F/K/A HOECHST CELANESE CORPORATION,	:	
Appellant,	:	C.A. No. 01A-03-001-SCD
v.	:	
DIRECTOR OF REVENUE,	:	
Appellee.	:	

Submitted: September 4, 2001
Decided: January 9, 2002

OPINION

This appeal from the Tax Appeal Board ("Board")[1] turns on an issue of first impression in Delaware, the interpretation of the section of the Corporate Income Tax statute related to the sale of real property located in

[1] The Board's decision is dated February 9, 2001. On December 4, 1992, Hoechst timely filed an Amended Delaware Corporate Income Tax Return (the "amended return") for the year in issue, requesting a refund in the amount of $817,166. In a letter dated January 20, 1993, Director of Revenue ("Director") issued a Notice of Determination to Hoechst, denying Hoechst's protest of Director's prior denial of its refund claim. Hoechst timely filed the Petition with the Board on March 12, 1993, in response to the Notice of Determination.

Delaware that is part of an integrated multistate manufacturing operation.[2]

Facts

There are no factual disputes. The parties have stipulated to the following:

The principal place of business of Hoechst Celanese Corporation ("Hoechst") is in New Jersey. For the tax year ending December 31, 1989 (the "year in issue"), Hoechst timely filed a Delaware Corporation Income Tax Return (the "original return"). Hoeschst paid Delaware corporation income tax through tentative tax payments and a payment with the original return in the total amount of $1,224,075. The taxes in controversy are Delaware corporation income taxes paid for the year in issue in the amount of $817,166, plus interest.

In the calendar year 1989, Hoechst sold its PVC Film Division plant ("PVC plant"), located in New Castle, Delaware. Hoechst had owned and operated the PVC plant since 1968 (the "ownership period") as part of an integrated multistate manufacturing operation. In the same year, Hoechst also sold plants in Louisiana and Texas.

In computing federal taxable income, Hoechst was required to include gain from the sale of the PVC plant. This gain included (1) ordinary income from the "recapture" of previously allowed depreciation, and (2) gain from the disposition of property, characterized as I.R.C. § 1231

[2] 30 *Del. C.* § 1903(b)(3).

gain. Hoechst's federal taxable income, the starting point for determining a corporation's Delaware corporation income tax, was $120,384,436.

The total gain recognized for federal income tax purposes upon the sale of the PVC plant for the year in issue was $14,004,480 (the sum of $127,344 and $13,877,136). The amount of recapture income is $45,242,998.

Depreciation recapture on the PVC plant, which is the income at issue in this matter and which forms the basis for the refund claim, calculated for federal income tax purposes, totaled $9,903,729 (the "Delaware recapture") and represents 8.2% of Hoechst's total federal taxable income for 1989.

In accordance with the instructions to the 1989 Form 1100, the original return allocated the full $14,004,480 of gain from the sale of the PVC plant (i.e., the $9,903,729 Delaware recapture and the balance, which is the economic gain) to Delaware, and Hoechst paid Delaware corporation income tax on said gain aggregating $1,218,390 (including $861,624 of tax on the Delaware recapture). Hoechst also paid tax in other states on the apportioned Delaware recapture in the aggregate amount of $649,030. On the original return Hoechst also reported $77,992,764 of taxable income that was allocated under the Delaware statutes to states other than Delaware. Of this amount, $63,499,534 was gain on the sale of depreciable tangible property located outside of Delaware that was sold in the year in issue. None of the income allocated to other states entered into the calculation of Hoechst's Delaware corporation income tax, as reflected in the original return.

The amended return for the year in issue excluded the Delaware recapture from the gain allocated to Delaware. In the amended return, Hoechst included the $9,903,729 Delaware recapture amount in the income subject to apportionment by Delaware and other states, but continued to allocate the balance of the gain from the sale of the PVC plant to Delaware. The amended return also included in apportionable income the $35,339,269 of recapture gain included in the aforementioned $77,992,764 of income allocated on the original return to other states. The total amount of recapture income reclassified as apportionable income in the amended return was $45,242,998. The amended return did not include in apportionable income the economic gain of $28,160,265 on the sale of depreciable tangible property located outside of Delaware that was sold in the year in issue.

Through the ownership period, Hoechst filed income tax returns in 34 taxing jurisdictions, including Delaware, Ohio and South Carolina (the 33 taxing jurisdictions other than Delaware are hereinafter sometimes referred to as the "other jurisdictions"), apportioning between 82% and 95.6% of its business income among those states. In the year in issue the aggregate apportionment percentage among all jurisdictions in which Hoechst filed returns was 95.6%. Delaware's average apportionment factor in these years ranged between a high of 8.83% between 1968 and 1980, and a low of 1.96% between 1981 and 1989. The Delaware apportionment factor in 1989 was 1.12%. Except for Ohio and South Carolina, all of the other jurisdictions apportioned the gain from the sale of the PVC plant, rather than geographically allocating it. Ohio and South Carolina each geographically allocated the $4,224,226 economic gain from the sale of the real estate component

of the PVC plant outside of their tax bases. Ohio and South Carolina, like the rest of the other jurisdictions, apportioned the $9,903,729 Delaware recapture.

During the ownership period, Hoechst included PVC plant depreciation deductions in its determination of federal taxable income. Hoechst apportioned its federal taxable income among the states in which it conducted business. Therefore, Hoechst apportioned its PVC plant depreciation deductions among the states in which it conducted business, including the State of Delaware, receiving an apportioned amount of its depreciation deduction benefit for Delaware tax purposes. Hoechst, in all years of the ownership period, did not receive the full income tax benefit of the depreciation deduction because less than 100% of its income was apportioned to states with income taxes.

The depreciation expense claimed in all states on PVC plant assets throughout the entire ownership period of the facility, totaled $31,582,830. The portion of that number deducted in Delaware during the ownership period under Delaware's apportionment percentage was $1,363,951. The tax benefit obtained by Hoechst from those deductions for those years for Delaware purposes was $118,664. The portion of that number deducted in the other jurisdictions during the ownership period under the average apportionment percentage of the other jurisdictions was $30,218,879. The tax benefit obtained by Hoechst from these deductions for those years using the average tax rate was $1,845,796.

During the ownership period, Hoechst included depreciation deductions attributable to plants, offices and facilities located in other states in its determination of

federal taxable income. Hoechst apportioned its federal taxable income among the states in which it conducted business, including Delaware. Therefore, Hoechst apportioned its depreciation deductions from plants, offices, and facilities not located in Delaware among the states in which it conducted business, including Delaware, receiving a depreciation deduction benefit for Delaware tax purposes. This benefit reduced Hoechst's federal income apportioned to Delaware, and thus reduced Delaware's corporation income tax during the ownership period by $520,750.

When plants, offices, and facilities located in other states were sold, any gain attributable to depreciation recapture under the Delaware statutes was allocated for Delaware corporation income tax purposes to the states wherein the real property was located. None of the previously deducted depreciation expense with respect to plants, offices, and facilities located in other states that was recaptured on the sale entered into the calculation of Delaware taxable income on the original return. It was, however, included on the amended return as part of the apportioned recapture income.

Standard of Review

In reviewing a decision of the Board, this Court must take due account of the experience and specialized competence of the Board, and of the purposes of the basic law under which the Board has acted. This Court's review is limited to a determination of whether the agency's decision

was supported by substantial evidence and correct as a matter of law.[3]

Discussion

The Board determined in its Decision and Order that: (1) the Delaware statute clearly and unambiguously required Hoechst to include in Delaware income the entire profit reported for federal income tax purposes on the sale of the plant; and (2) the Director did not abuse his discretion in denying Hoechst's request for an adjustment of its entire net income, pursuant to 30 *Del. C.* § 1903(c).

The Delaware statutory provisions relevant to this case provide:

> (b) "Taxable income" subject to taxation . . . means the portion of the entire net income of a corporation which is allocated and apportioned to this State in accordance with the following provisions:
>
> * * *
>
> (3) Gains and losses from the *sale* or other disposition of real property shall be *allocated to the state in which the property . . . is physically located*;
>
> (4) Gains and losses from the *sale* or other disposition of tangible property for which an allowance for depreciation is permitted for federal

[3] Administrative Procedures Act, 29 *Del. C.* § 10142(d); *United Water Delaware, Inc. v. Public Service Com'n*, Del. Supr., 723 A.2d 1172, 1173 (1999).

income tax purposes . . . shall *be allocated to the state where the property is physically located* or is normally used in the taxpayer's business.

* * *

(6) If the entire business of the corporation is transacted or conducted within this State, the remainder of its entire net income shall be allocated to this State. *If the business of the corporation is transacted or conducted in part without this State, such remainder, whether income or loss, shall be apportioned to this State* on the basis of the ratio obtained by taking the arithmetical average of these 3 ratios:

a. The average of the value . . . of all the real and tangible personal property . . . in this State . . . expressed as a percentage of the average of the value . . . of all such property . . . both within and without this State . . . ;

b. Wages, salaries and other compensation paid by the taxpayer to employees within this State . . . expressed as a percentage of all such wages, salaries and other compensation paid within and without this State . . . ;

c. Gross receipts from sales of tangible personal property physical [sic] delivered within this State . . . and gross income from other sources within this State . . . expressed as a percentage of all such gross receipts from sales of tangible personal property and gross income from other sources both within and without the State . . . .

(c) If, in the discretion of the Secretary of Finance, the application of the allocation or apportionment provisions of this section result in an unfair or inequitable proportion of the taxpayer's

> entire net income being assigned to this State, then the Secretary of Finance or the Secretary's delegate may permit or require the exclusion or alternation of the weight to be given to 1 or more of the factors in the formula specified above *or the use of separate accounting or other method to produce a fair and equitable result.*
>
> (emphasis added).[4]

In sum, the Corporation Income Tax statute recognizes the need to apportion ordinary income for a corporation transacting business in and outside the State and has provided a formula for calculating that number. Under the Board's interpretation of 30 *Del. C.* § 1903(b), there is no apportionment of the gain associated with the sale of real property in the state; 100% of that gain is taxable in Delaware. The Board concluded that full taxation is proper notwithstanding the fact that a portion of that gain was taxed by other states. In the instant case, Hoechst's sale of real estate in Delaware in 1989 resulted in the taxation of 187% of the proceeds of the sale of the Delaware plant.

The issue in this proceeding is whether the Director properly disallowed Hoechst's claim for refund of Delaware corporation income tax paid for the year in issue. The analysis begins with the question of whether 30 *Del. C.* § 1903(b) provides for the allocation of the entire profit on the sale of the Delaware plant to Delaware or whether the word "gains" in 30 *Del. C.* § 1903(b)(3) must be interpreted to exclude the depreciation which is recaptured at the time of the sale. Hoechst argues that 30 *Del. C.* § 1903 should

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[4] 30 *Del. C.* § 1903.

be interpreted to require only the allocation of the economic appreciation on the plant during the ownership ("economic gain"), not the recovery of depreciation deductions that were allowed on the plant during the ownership period ("recapture gain"). Hoechst reasons that because depreciation is apportioned, the recapture gain must also be apportioned. The economic gain on the sale of the plant was $4,100,751 while the recapture gain was $9,903,729. The definitional portion of the statute does not define "gain" or "gains."[5]

Delaware is out of step with the rest of the country in the way it handles the proceeds from the sale of a plant.[6] The Director acknowledges that his interpretation of the statute costs the State considerable revenue because Delaware foregoes revenue on sales of facilities in all other states that could be partially apportioned to Delaware.[7]

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[5] 30 *Del. C.* § 1901.

[6] Professor Richard D. Pomp, of the University of Connecticut, testified as an expert witness for Hoechst as follows:

> Q. Are you aware of any other states that would reach a similar, I didn't say identical, just a vaguely similar outcome as Delaware with expect [sic] to this identical transaction?
>
> A. There is no state that I'm aware of, and certainly none of the states in which they filed returns that would allocate the entire gain, both the recapture and the economic component of the gain to itself. Transcript of Hearing at 103 (February 14, 1997).

[7] Testifying about the impact on Delaware revenue of the Director's interpretation of 30 *Del. C.* § 1903 in the tax year 1989, the Director responded:

> A. The number of accounts with allocatable income, that was about 9,000 accounts, number of accounts with gains on the sale of real and depreciable or tangible property,

(Continued on following page)

His decision not to permit the refund was based on his conclusion that under the circumstances applicable to this taxpayer, throughout the ownership period, the tax is "fair and equitable."[8]

The first task of statutory interpretation is to determine whether 30 *Del. C.* § 1903(b)(3) is ambiguous.[9] A statute is ambiguous when it is reasonably susceptible to different conclusions or interpretations.[10] Ambiguity may be found if a literal reading of the statute would lead to an unreasonable or absurd result.[11] A taxing statute may not

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that's about 100 accounts, amount of gain and loss from real and intangible property located in Delaware, that's about $30 million of gain, $5 million of losses, and the net is 24.9 gain. And amount of gain/loss from real and intangible property located outside of Delaware is about 6.2 billion, losses about half a billion, and the net is about 5.7 billion.

Q. So on a net basis in '89, Delaware allocated to itself about 30 million in gain?

A. Yeah, in gross gain, yeah.

Q. And allocated outside of itself or forgave tax in the amount of about 1.6 billion?

A. No, 6.2 billion.

Q. 6.2 billion. I'm sorry. And that confirms your view that overall the statute is working fairly to tax only the business relations in Delaware?

A. Well, as a matter of fact I think it's working to tax less than could be taxed under an apportionment scheme.

Id. at 142.

[8] 30 *Del. C.* § 1903(c).

[9] *Newtowne Vill. Serv. v. Newtowne Rd. Dev Co., Inc.*, Del. Supr., 772 A.2d 172, 175 (2001).

[10] *Id.*

[11] *Id.*

be sustained if, as applied to the taxpayer, it operates "unreasonably or arbitrarily . . . in attributing to [a state] a percentage of income out of all appropriate proportion to the business transacted by the appellant in that state."[12] "If there is doubt regarding the breadth of a taxing statute, the court must construe the statute against the taxing authority and in favor of the taxpayer."[13]

Under the facts of this case, taxation of 187% of the proceeds of the sale of the PVC plant because of the almost double taxation of the recapture component of the gain on the sale of the property constitutes an unreasonable result. Interpreting the word "gain" in the statute to mean only the economic gain results in a tax liability which is consistent with the apportionment of the ordinary income among the various states where Hoechst was doing business, and reconciles the apportionment provisions of subpart (6) with the gain and losses part of subpart (3) and (4).

This conclusion is supported by *Hercules Inc. v. South Carolina Tax Comm'n.*[14] which is squarely on point. Hercules sold a plant and apportioned the gain from the sale among all of the approximately forty states in which it did business and which also required the payment of income tax. The Tax Commission disallowed apportionment of the gain and assessed additional taxes on the basis of a code

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[12] *Hans Rees' Sons v. State of North Carolina ex. rel. Maxwell,* 283 U.S. 123, 135 (1931).

[13] *Abrern-Wilmington v. Director of Revenue,* Del. Supr., 596 A.2d 1385, 1388 (1991).

[14] *Hercules Inc. v. South Carolina Tax Comm'n,* S.C. Supr., 304 S.E.2d 815 (1983).

provision which taxed transactions occurring wholly within the state. The South Carolina Supreme Court held:

> If we were to hold that [the tax code] allows South Carolina the sole benefit of recapturing all of the depreciation taken, one of two gross inequities would result. Either all other states which allowed depreciation would be denied the right to recapture or Hercules would be subjected to double taxation. It cannot be seriously argued that the legislature intended such a result.[15]

The Court interpreted "gain" in the statute to be the gain, which reflects a "true and actual profit as contrasted with a profit brought into being by reason of recapturing depreciation. In addition, the gain would, of course, include the recapture of depreciation actually allocated to South Carolina."[16] The analysis of *Hercules* applies here. The term "gain" in 30 *Del. C.* § 1903(b)(3) is the economic gain from the sale of the property, $4,100,751 plus the Delaware depreciation of $118,664. In view of the conclusion reached here, it is not necessary to consider Hoechst's argument regarding the constitutionality of the statute or the Director's abuse of discretion. The decision of the Board is reversed and remanded for further proceedings in accordance with this decision. In view of the age of this matter and the inexplicable delay in its resolution below, the Board is directed to report on this status of this remand, unless appealed, on or before March 15, 2002.

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[15] *Id.* at 818.

[16] *Id.*

IT IS SO ORDERED.

/s/ Susan C. Del Pesco
Judge Susan C. Del Pesco

Original to Prothonotary
xc: Stanford L. Stevenson, III, Esquire
Paul H. Frankel, Esquire
Michael A. Pearl, Esquire
Jos. Patrick Hurley, Esquire

APPENDIX C

TAX APPEAL BOARD OF THE
STATE OF DELAWARE

HOECHST CELANESE CORPORATION	)	
Petitioner,	)	
v.	)	DOCKET NO. 1166
DIRECTOR OF REVENUE,	)	
Respondent.	)	

BEFORE: John H. Cordrey, Esquire, Chairman; Regina Dudziec and Cynthia L. Hughes; Members.

Paul H. Frankel, Esq. and Stanford L. Stevenson, III, Esq. Attorneys for Petitioner

Jos. Patrick Hurley, Esquire, Deputy Attorney General for Respondent.

DECISION AND ORDER

JOHN H. CORDREY, ESQUIRE, CHAIRMAN.

Petitioner conducts an integrated, multi-state manufacturing operation. The issue in this case involves Delaware's method of taxing Petitioner's gain on the sale of real estate, a plant, located in Delaware. Petitioner filed a claim for refund with respect to its 1989 corporate tax return, which claim was denied by Respondent. Petitioner argues that Delaware's method of taxing sales of assets within the state is unfair and/or unconstitutional when applied to the operations of a multi-state, corporate taxpayer. Alternatively, Petitioner argues that the Director of Revenue should be

compelled to exercise the discretion granted him under 30 *Del. C.* § 1903(c) to make an adjustment to the Petitioner's tax liability.

Respondent argues that the Delaware taxation scheme for these types of transactions, although admittedly unusual, is perfectly legal, appropriate and within the discretion of the Legislature. Further, Respondent argues that the Director's decision not to exercise the discretion permitted under 30 *Del. C.* § 1903(c) to adjust the Petitioner's tax liability is entirely appropriate and that the Board should not compel the Director to exercise discretion he does not feel is warranted.

STIPULATED FACTS

The Parties entered into an extensive Stipulation of Facts which is a part of the record and will not be recited here, but rather a synopsis of those agreed facts that are important in the decision are as follows:

1. The issue is whether Respondent properly disallowed Petitioner's claim for refund for the 1989 tax year.

2. Petitioner timely filed an original return for 1989 showing a total tax of $1,224,075.

3. Petitioner subsequently filed an amended return requesting a refund in the amount of $817,166.

4. Respondent denied the claim for refund.

5. Petitioner timely filed an appeal with this Board.

6. In 1989, Petitioner sold real estate which contained a plant in Delaware which it had operated since 1968 as part of an integrated, multi-state manufacturing operation.

7. Petitioner's federal return for 1989 showed federal taxable income of $120,384,436. This federal amount included the gain on the sale of the Delaware plant of $14,004,480. This gain consisted of two components: (1) "economic gain", or the difference between the unadjusted cost basis of the plant and its sales proceeds, of $4,100,751, and (2) "recapture gain", or the amount of gain representing the decrease in federal tax basis of the plant because of past depreciation deductions allowed on the plant, of $9,903,729.

8. The federal return showed total recapture gains of $45,242,998, of which $9,903,729 related to the Delaware plant sale and the rest related to other realized in other states.

9. In accordance with the Delaware instructions, Petitioner allocated the entire $14,004,480 to Delaware in its original filing.

10. Petitioner paid tax in other states on the apportioned Delaware recapture of $649,030. [This resulted from the fact that most states apportion recapture income based on multi-factor apportionment formulas, unlike Delaware which sources the income to the state where the asset was located].

11. Petitioner had $77,992,764 of taxable income that was allocated to states other than Delaware, including gains on the sale of depreciable property of $63,499,534. None of the income allocated to other states entered into the calculation of Petitioner's Delaware corporate income tax, as reflected in the original return.

12. The amended return excluded the recapture component of the gain from allocation to Delaware but continues to allocate the economic portion to Delaware.

13. During the ownership period, Petitioner's apportionment factors to Delaware ranged from a high of 8.83% to a low of 1.1295%. The factors were higher in the early years of ownership, then dropped dramatically in the late 1970's and the 1980's. The Delaware apportionment factor in 1989 (the year of sale) was 1.1295%.

14. Total depreciation deductions claimed on the plant during the ownership period were $31,582,830. Of that amount, $1,363,951 (or 4.3%) were apportioned to Delaware. The tax benefit in Delaware from those deductions was $118,664. Depreciation deductions from plants located outside of Delaware and partially apportioned to Delaware yielded a tax benefit in Delaware of $520,750 during the ownership period.

15. When any plants, offices and other facilities located in other states were sold, any gain attributable to depreciation recapture on those facilities were allocated for Delaware tax purposes to the states where the assets were located.

FACTUAL HEARING

The Board also heard testimony from Professor Richard Pomp, Michael H. Lippman and William Remington, Professor Pomp and Mr. Lippman were both offered as experts by the Petitioner and the Board allowed them to testify as experts in the field of taxation matters.

Petitioner's experts testified that the Delaware statutory scheme of allocating the entire profit of the sale of the Delaware plant would result in Petitioner being taxed by Delaware and other jurisdictions on 187 percent of the profit. This taxation was as a result of most of the other states where Petitioner conducts business utilizing a

different system of apportioning taxes than Delaware. Most states apportion all of the income of the corporation amongst the states where it conducts business. Delaware utilizes a unique approach which first allocates income, whether business or non-business, to the state where the asset is geographically located or used; the remaining income is then apportioned in accordance with a standard three factor formula designed to approximate the portion of Petitioner's income that relates to Delaware.

William Remington testified that he has never exercised his discretionary authority under 30 *Del. C.* §1903(c). He was not aware of any other Delaware Director of Revenue who had exercised said discretion. The Board finds that William Remington considered the request for the refund and the exercise of his discretion but declined to grant the relief because he felt that in consideration of the totality of the circumstances the tax assigned to Delaware was fair. He was also concerned that if he granted the request in this matter he would be required to grant similar relief to other taxpayers and impose additional taxes in other cases. This would effectively result in the Director rewriting the statutes, which he felt unwarranted in this case.

The Board, in addition to the facts stated above, specifically adopts the Respondent's proposed Findings of Fact numbers 1 through 19 as its findings of fact.

ARGUMENTS

Petitioner and Respondent agree that the $4.1 million "economic gain" should be taxed in Delaware. The remaining issue is the taxation of the $9.9 million of "recapture income".

The "Fairness" Arguments

Numerous arguments were advanced and cases cited by Petitioner to try to establish that the Delaware system was "unfair". During the factual hearing, Petitioner presented several expert witnesses who testified that Delaware's system of taxing in-state facility sales and not taxing out-of-state facility gains was not in step with the vast majority of states. One expert stated that the Delaware system was discriminatory because it created a higher tax on this transaction then would have occurred if Petitioner had only done business in Delaware. Petitioner cited numerous examples of the "unfairness" of the taxation regime as it relates to this sale of property. It was noted that $14 million of the entire $30 million of gains taxed to all Delaware taxpayers in 1989 related to this taxpayer. It was argued that the plant in question generated only $1.3 million of depreciation deductions that were apportioned to Delaware, resulting in tax savings of only $118,000. This pales in comparison to the $817,166 of taxes on recapture income which Petitioner claims should be refunded. Respondent argues that no system of allocation and apportionment is exact. Rather these systems are proxies for exactness, which can never be achieved. The Delaware system is admittedly out of step with the mainstream, but is nonetheless fair as applied to multi-state taxpayers as a class. Respondent argues that Delaware is consistent in that it foregoes revenue on sales of facilities in all 49 other states that could be partially apportioned to Delaware under a traditional allocation and apportionment regime. Respondent noted that the Hercules case, which is discussed later, involved a corporation that is headquartered in Delaware and has extensive research facilities in Delaware. Yet Delaware did not tax any of the gain on Hercules sale of its South Carolina plant. This is

consistent with Delaware law, and although it yields a result that is not in the mainstream with other states, it is not an unfair result. Rather it is the result that was intended by the Delaware Legislature.

The Statutory Argument

Petitioner argues that 30 *Del. C.* §1903(b) requires the apportionment of Petitioner's recapture income. The law provides that (1) "[g]ains or losses from the sale or other disposition of real property shall be allocated to the State in which the property is physically located" and (2) "[g]ains or losses from the sale or other disposition of tangible property for which an allowance for depreciation is permitted for federal income tax purposes shall be allocated to the state where the property is physically located or is normally used in the taxpayer's business". Petitioner argues that these provisions should be interpreted to require only the allocation of economic gains and that gains arising from recapture should be included in the apportionment base. Petitioner further argues that this law is not clear and should be interpreted to mean only depreciation allowed in Delaware should be allocated, and that the recapture component is not a "gain" within the meaning of the statute.

Respondent argues that the statute's meaning is clear and unambiguous. The starting point for Delaware taxable income is federal taxable income. The Internal Revenue Code does not say that depreciation recapture is not "gain". The Delaware Stature [sic] clearly describes how different classes of federal taxable income are to be allocated or apportioned.

The Hercules Case

Petitioner contends that the Hercules case in South Carolina, *Hercules, Inc. v. South Carolina Tax Commission*, S.C. Supr., 304 S.E.2d 815 (1983), is exactly on point and, although not controlling, should guide the adjudication of this case. In this case, the South Carolina Supreme Court ruled that South Carolina could not tax the entire gain on a plant located in the state.

Respondent contends that the *Hercules* decision was based on ambiguity between two competing Code sections. South Carolina has a statute that reads, in part: "Income tax as provided in this chapter shall be imposed on a base which reasonably represents that proportion of the trade or business carried on with this State." Since Delaware has no similar competing statute, the ambiguity which the South Carolina Supreme Court relied on is not present in Delaware law. Respondent also noted that regarding Hercules, Delaware did not tax the gain on the sale of the South Carolina plant even though Hercules is headquartered in Delaware.

The Discretion Argument

Petitioner argues that the Director of Revenue should have used his discretionary authority under 30 *Del. C.* § 1903(c) to modify the result of the Delaware statute. Under oral examination the Director admitted that he has never exercised the discretionary provision. Petitioner contends *F.W. Woolworth Co. v. Director of Div. Of Taxation*, N.J. Supr., 213 A.2d 1 (1965) held that the Director's exercise of the permitted discretion is not optional and must be applied whenever unfairness is found.

The Director of Revenue testified personally. Although his predecessor made the decision not to grant discretionary review, he concurs with the decision. He testified that the Delaware statute refers to the taxpayer's "entire income" not just one component, and that the taxation of the entire income is what he looks at in determining if the exercise of discretion is warranted. He testified that based on the income generated on sales of out-of-state plants in the same year (for which Delaware received no tax) he did not feel that the amount of Petitioner's *total* state tax paid was unreasonably allocated to Delaware.

FINDING

The Board concludes that the Delaware statute is clear and unambiguous as it relates to the transaction in question. Petitioner's proposed interpretation of the statute is contrary to the clear and unambiguous meaning of the statute.

Regarding the *Hercules* case, the Board concludes that this case is distinguished from the current case because of the competing provisions of two different statutes created ambiguity which the South Carolina Supreme Court was required to resolve. We find no such ambiguity in the Delaware statute and we find no ambiguity in the meaning of the Delaware statute.

Finally, with respect to the discretion argument, we do not find the current circumstances to be such that the Director has abused his discretion in denying the Petitioner's request for a refund. When viewed in the context of the taxpayer's entire net income in all states in 1989 and the Delaware statutory scheme which has inured to the benefit of this and other tax payers who have sold

assets in other jurisdictions without Delaware seeking to tax such transactions, we find no abuse of discretion by the Director.

Accordingly, the Petition is denied.

IT IS SO ORDERED this 9th day of February, 2001.

/s/ John H. Cordrey /s/ Cynthia L. Hughes

/s/ Regina C. Dudziec

APPENDIX D

IN THE SUPERIOR COURT OF THE
STATE OF DELAWARE

IN AND FOR NEW CASTLE COUNTY

CNA HOLDINGS, INC., f/k/a HOECHST CELANESE CORPORATION,	:	C.A. No. 01A-03-001 SCD
v.	:	
DIRECTOR OF REVENUE	:	

ORDER

For the reasons set forth in the decision of the Supreme Court of Delaware on March 21, 2003, the appeal from the decision of the Delaware Tax Appeal Board is AFFIRMED.

IT IS SO ORDERED this 23 day of May, 2003.

/s/ Susan C. Del Pesco
Judge Susan C. Del Pesco

Original to Prothonotary

APPENDIX E

Delaware Statutes Involved

Title 30, § 1902. Imposition of tax on corporations; exemptions.

(a) Every domestic or foreign corporation that is not exempt under subsection (b) of this section shall annually pay a tax of 8.7 percent on its taxable income, computed in accordance with § 1903 of this title, which shall be deemed to be its net income derived from business activities carried on and property located within the State during the income year. Any receiver, referee, trustee, assignee or other fiduciary or any officer or agent appointed by any court who conducts the business of any corporation shall be subject to the tax imposed by this chapter in the same manner and to the same extent as if the business were conducted by the corporation.

* * *

Title 30, § 1903. Computation of taxable income.

(a) The "entire net income" of a corporation for any income year means the amount of its federal taxable income for such year as computed for purposes of the federal income tax increased by (i) any interest income (including discount) on obligations issued by states of the United States or political subdivisions thereof other than this State and its subdivisions, and (ii) the amount of any deduction allowed for purposes of the federal income tax pursuant to § 164 of the Internal Revenue Code (26 U.S.C. § 164) for taxes paid on, or according to or measured by, in whole or in part, such corporation's net income or profits, to any state (including this State), territory, county or

political subdivision thereof, or any tax paid in lieu of such income tax, and its federal taxable income shall be further adjusted by eliminating:

* * *

(b) "Taxable income" subject to taxation under this chapter means the portion of the entire net income of a corporation which is allocated and apportioned to this State in accordance with the following provisions:

(1) Rents and royalties (less applicable or related expenses) from tangible property shall be allocated to the state in which the property is physically located;

(2) Patent and copyright royalties (less applicable or related expenses) shall be allocated proportionately to the states in which the product or process protected by the patent is manufactured or used or in which the publication protected by the copyright is produced or printed;

(3) Gains and losses from the sale or other disposition of real property shall be allocated to the state in which the property, and expenses incurred in connection with dispositions resulting in such gains and losses, is physically located;

(4) Gains and losses from the sale or other disposition of tangible property for which an allowance for depreciation is permitted for federal income tax purposes, and expenses incurred in connection with dispositions resulting in such gains and losses, shall be allocated to the state where the property is physically located or is normally used in the taxpayer's business;

(5) Interest (including discount) to the extent included in determining entire net income under subsection

(a) of this section, less related or applicable expenses, shall be allocated to the state where the transaction took place which resulted in the creation of the obligation with respect to which the interest was earned;

(6) If the entire business of the corporation is transacted or conducted within this State, the remainder of its entire net income shall be allocated to this State. If the business of the corporation is transacted or conducted in part without this State, such remainder, whether income or loss, shall be apportioned to this State on the basis of the ratio obtained by taking the arithmetical average of these 3 ratios:

a. The average of the value, at the beginning and end of the income year, of all the real and tangible personal property, owned or rented, in this State by the taxpayer, expressed as a percentage of the average of the value at the beginning and end of the income year of all such property of the taxpayer both within and without this State; provided, that any property, the income from which is separately allocated under paragraph (1) of this subsection or which is not used in the taxpayer's business, shall be disregarded. For the purposes of this paragraph, property owned by the taxpayer shall be valued at its original cost to the taxpayer, and property rented by the taxpayer shall be valued at 8 times the annual rental;

b. Wages, salaries and other compensation paid by the taxpayer to employees within this State, except general executive officers, during the income year expressed as a percentage of all such wages, salaries and other compensation paid within and without this State during the income year to all employees of the taxpayer, except general executive officers;

c. Gross receipts from sales of tangible personal property physically delivered within this State to the purchaser or the purchaser's agent (but not including delivery to the United States mail or to a common or contract carrier for shipment to a place outside this State) and gross income from other sources within this State for the income year expressed as a percentage of all such gross receipts from sales of tangible personal property and gross income from other sources both within and without the State for the income year; provided, that any receipts or items of income that are excluded in determining the taxpayer's entire net income or are directly allocated under paragraphs (1) to (6) of this subsection shall be disregarded.

(c) If, in the discretion of the Secretary of Finance, the application of the allocation or apportionment provisions of this section result in an unfair or inequitable proportion of the taxpayer's entire net income being assigned to this State, then the Secretary of Finance or the Secretary's delegate may permit or require the exclusion or alteration of the weight to be given to 1 or more of the factors in the formula specified above or the use of separate accounting or other method to produce a fair and equitable result.

* * *

APPENDIX F

BEFORE THE TAX APPEAL BOARD
FOR THE STATE OF DELAWARE

HOECHST CELANESE CORPORATION,	)	
Petitioner,	)	
v.	)	Docket No. 1166
DIRECTOR OF REVENUE,	)	
Respondent.	)	

STIPULATION OF AGREED FACTS

Petitioner, Hoechst Celanese Corporation, and Respondent, State of Delaware Department of Finance, Division of Revenue, for purposes of this proceeding only, do hereby agree and stipulate as follows:

1. The issue in this proceeding is whether Respondent properly disallowed Petitioner's claim for refund of Delaware corporation income tax paid for the taxable year ending December 31, 1989.

Jurisdictional Documents

2. Attached hereto as Exhibit A is a copy of a Notice of Determination, dated January 20, 1993, issued to Petitioner by Respondent.

3. Attached hereto as Exhibit B is a copy of the Notice of Appeal ("Petition") that was timely filed by Petitioner on March 12, 1993.

Procedural Background

4. Petitioner's principal place of business is located at Route 202-206, Somerville, NJ 08876. For the taxable year ending December 31, 1989 (the "Year in Issue"), Petitioner timely filed a Delaware Corporation Income Tax Return (the "Original Return"), attached hereto as Exhibit C. Petitioner paid Delaware corporation income tax through tentative tax payments and a payment with the Original Return in the total amount of $1,224,075.

5. On December 4, 1992, Petitioner timely filed an Amended Delaware Corporation Income Tax Return for the Year in Issue (the "Amended Return"), requesting a refund in the amount of $817,166. The Amended Return is attached hereto as Exhibit D.

6. In a letter dated January 20, 1993, Respondent issued a Notice of Determination to Petitioner, denying Petitioner's protest of Respondent's prior denial of its refund claim. Notice of Determination, Exhibit A.

7. Petitioner timely filed the Petition with the Tax Appeal Board on March 12, 1993 in response to the Notice of Determination. Petition, Exhibit B.

Factual Background

8. The taxes in controversy are Delaware corporation income taxes paid for the year in issue in the amount of $817,166, plus interest.

9. In the calendar year 1989, Petitioner sold its PVC Film Division plant ("PVC"), located in New Castle, Delaware. Petitioner had owned and operated the PVC plant since 1968 (the "Ownership Period") as part of an integrated

multistate manufacturing operation. In the same year, Petitioner also sold plants in Louisiana and Texas.

10. In computing federal taxable income, Petitioner was required to include gain from the sale of PVC facility. This gain included (1) ordinary income from the "recapture" of previously allowed depreciation, and (2) gain from the disposition of property, characterized as I.R.C. § 1231 gain. Petitioner's federal taxable income, the starting point for determining a corporation's Delaware corporation income tax, in 1989 was $120,384,436.

11. The total gain recognized for federal income tax purposes upon the sale of the PVC plant for the Year in Issue amounted to $14,004,480 (the sum of $127,344 and $13,877,136). Petitioner's 1989 federal Form 4797, Sales of Business Property, attached hereto as Exhibit E.

12. The parties agree that the various amounts set forth in the Original Return, the Amended Return and in Petitioner's 1989 federal Form 4797, Sales of Business Property (Exhibit C), are accurate and that the mathematical computations set forth therein are correct. Petitioner and Respondent do not agree on the classification of the $45,242,998 of federal recapture income as non-apportionable income (as in the Original Return) or as income subject to apportionment (as in the Amended Return); however they do agree that the amount of such recapture income is accurate.

13. Depreciation recapture on the PVC plant, which is the income at issue in this matter and which forms the basis for the refund claim, calculated for federal income tax purposes, totaled $9,903,729 (the "Delaware Recapture") and represents 8.2% of Petitioner's total federal taxable income for 1989.

14. In accordance with the instructions to the 1989 Form 1100, the Original Return allocated the full $14,004,480 of gain from the sale of PVC (*i.e.*, the $9,903,729 Delaware Recapture and the balance, which is the economic gain) to Delaware, and Petitioner paid Delaware corporation income tax on said gain aggregating $1,218,390 (including $861,624 of tax on the Delaware Recapture). Petitioner also paid tax in other states on the apportioned Delaware Recapture in the aggregate amount of $649,030. On the Original Return Petitioner also reported $77,992,764 of taxable income that was allocated under the Delaware statutes to states other than Delaware. *See* Exh. C, Original Return, Schedule 2, line 8, col. 2. Of this amount, $63,499,534 was gain on the sale of depreciable tangible property located outside of Delaware that was sold in the Year in Issue. *Id.*, Schedule 2, line 4, col. 2. None of the income allocated to other states entered into the calculation of Petitioner's Delaware corporation income tax, as reflected in the Original Return.

15. The Amended Return for the Year in Issue excluded the Delaware Recapture from the gain allocated to Delaware. In the Amended Return, Petitioner included the $9,903,729 Delaware Recapture amount in the income subject to apportionment by Delaware and other states, but continued to allocate the balance of the gain from the sale of PVC to Delaware. The Amended Return also included in apportionable income the $35,339,269 of recapture gain included in the aforementioned $77,992,764 of income allocated on the Original Return to other states. The total amount of recapture income reclassified as apportionable income in the Amended Return was $45,242,998. *See* Exh. D, Amended Return, line 7, col B. The Amended Return did not include in apportionable income the economic

gain of $28,160,265 on the sale of depreciable tangible property located outside of Delaware that was sold in the Year in Issue. *Id.* Schedule 2, line 4, col 2.

16. Through the Ownership Period, Petitioner filed income tax returns in 34 taxing jurisdictions, including Delaware, Ohio and South Carolina (the 33 taxing jurisdictions other than Delaware are hereinafter sometimes referred to as the "Other Jurisdictions"), apportioning between 82% and 95.6% of its business income among those states. In the Year in Issue the aggregate apportionment percentage among all jurisdictions in which Petitioners filed returns was 95.6%. Delaware's average apportionment factor in these years ranged between a high of 8.83% between 1968 and 1980, and a low of 1.96% between 1981 and 1989. The Delaware apportionment factor in 1989 was 1.12%. Except for Ohio and South Carolina, all of the Other Jurisdictions apportioned the gain from the sale of PVC, rather than geographically allocating it. Ohio and South Carolina each geographically allocated the $4,224,226 economic gain from the sale of the real estate component of the PVC plant (see Exhibit E, Form 4797 for Delaware, part III, line 24, column A) outside of their tax bases. Ohio and South Carolina, like the rest of the Other Jurisdictions, apportioned the $9,903,729 Delaware Recapture. For the Year in Issue, Ohio's apportionment percentage was 1.60420%, and South Carolina's was 23.7131%.

17. During the Ownership Period, Petitioner included PVC depreciation deductions in its determination of federal taxable income. Petitioner apportioned its federal taxable income among the states in which it conducted business. Therefore, Petitioner apportioned its PVC depreciation deductions among the states in which it

conducted business, including the State of Delaware, receiving an apportioned amount of its depreciation deduction benefit for Delaware tax purposes. Petitioner in all years of the Ownership Period did not receive the full income tax benefit of the depreciation deduction because less than 100% of its income was apportioned to states with income taxes.

18. The depreciation expense claimed in all states on PVC assets throughout the entire Ownership Period of the facility, totaled $31,582,830. The portion of that number deducted in Delaware during the Ownership Period under Delaware's apportionment percentage aggregated $1,363,951. The tax benefit obtained by Petitioner from those deductions for those years for Delaware purposes aggregated $118,664. The portion of that number deducted in the Other Jurisdictions during the Ownership Period under the average apportionment percentage of the Other Jurisdictions aggregated $30,218,879. The tax benefit obtained by Petitioner from these deductions for those years using the average tax rate was $1,845,796.

19. During the Ownership Period, Petitioner included depreciation deductions attributable to plants, offices and facilities located in other states in its determination of federal taxable income. Petitioner apportioned its federal taxable income among the states in which it conducted business, including Delaware. Therefore, Petitioner apportioned its depreciation deductions from plants, offices and facilities not located in Delaware among the states in which it conducted business, including Delaware, receiving a depreciation deduction benefit for Delaware tax purposes. This benefit reduced Petitioner's federal income apportioned to Delaware, and thus reduced Delaware corporation income tax during the Ownership Period by $520,750.

20. When plants, offices, and facilities located in other states were sold, any gain attributable to depreciation recapture under the Delaware statutes was allocated for Delaware corporation income tax purposes to the states wherein the real property was located. None of the previously deducted depreciation expense with respect to plants, offices, and facilities located in other states that was recaptured on the sale entered into the calculation of Delaware taxable income on the Original Return. It was, however, included on the Amended Return as part of the apportioned recapture income.

21. Petitioner's PVC plant was regulated by the Delaware Department of Natural Resources and Environmental Control ("DNREC"), specifically the Division of Air Quality, the Division of Waste Management and the Division of Water Resources within DNREC. The plant's operation required air pollution control permits, oversight by the Division of Waste Management, and participation through permitting in the National Pollution Discharge Elimination System to limit water pollution.

22. In its protest to the Respondent's initial denial of the refund claim, Petitioner relied in part upon 30 *Del. C.* § 1903(c) which provides:

> If, in the discretion of the Secretary of Finance, the application of the allocation or apportionment provisions of this section result in an unfair or inequitable proportion of the taxpayer's entire net income being assigned to this State, then the Secretary of Finance or his delegate may permit or require the exclusion or alteration of the weight to be given to 1 or more of the factors in the formula specified above or the use of separate accounting or other method to produce a fair and equitable result.

HOECHST CELANESE
CORPORATION

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APPENDIX G

EXPERT OPINION OF PROFESSOR RICHARD D. POMP

HOECHST CELANESE CORPORATION

FEBRUARY 1, 1997

A. Statement of Facts

You have asked me to testify regarding the structure of state tax laws throughout the country, including those of the states in which Hoechst Celanese Corporation (hereinafter referred to as "taxpayer") filed returns in 1989. You have asked me to describe the interaction of Delaware tax law with the tax laws of the thirty-three other jurisdictions in which Hoechst was taxable. In light of the tax structure of these other jurisdictions, you have requested my opinion regarding the impact of the Secretary of Finance's failure to exercise his discretion under 30 Del. Code § 1903(c).

The facts, as I understand them, are as follows. The taxpayer is based in New Jersey and conducts a nationwide business. The taxpayer owns and operates plants in many states, including, until its sale in 1989, a PVC film plant in Delaware. The proper treatment of the sales proceeds of the tangible assets of that plant is at issue in this case.

During the years in which the taxpayer owned the PVC plant, Delaware law required the corporation to include the income generated by the operations of that plant in its entire net income, part of which was apportioned to Delaware. The ownership of the plant was also properly reflected in the taxpayer's Delaware apportionment percentage. The real and tangible assets of the plant,

for example, were included in the Delaware numerator of the taxpayer's property factor. The wages of plant personnel were included in the numerator of the taxpayer's Delaware payroll factor.

In 1989, the taxpayer sold the PVC plant in Delaware. Under Delaware law, gain on real and tangible assets located in that State are allocated to it. The taxpayer's original return for 1989 allocated all gain on these assets to Delaware. Of the thirty-four jurisdictions in which the taxpayer filed returns, Delaware was the only one that treated all of the gain as allocable income. With the exception of Ohio and South Carolina, all of the other jurisdictions treated the gain on the sale of the assets of the plant as apportionable income. Ohio and South Carolina apportioned the amount of the recapture gain on the real property (i.e., the amount of the gain attributable to previously claimed depreciation), but did not tax any of the economic gain (i.e., the difference between the total gain on the sale of an asset and the recapture gain) on the sale of real property in Delaware.

Petitioner subsequently filed an amended return in which it excluded from allocable gain the recapture gain. The taxpayer allocated to Delaware the amount of the economic gain on the sale of the Delaware assets.

The State rejected the taxpayer's amended return.

Because Delaware allocated to itself and taxed in full all of the gain on the sale of the Delaware plant, whereas thirty-one other jurisdictions apportioned all of the same gain, and two jurisdictions (Ohio and South Carolina)

apportioned most of the same gain),[1] the result was that 187% of the gain was taxable.

Table One demonstrates the multiple taxation of the gain. Column one of Table One is the amount of the gain on the sale of the tangible and real assets of the PVC plant in Delaware. Column two is the taxpayer's aggregate apportionment percentage in 1989, excluding Delaware. It is calculated by adding up the taxpayer's apportionment percentage in each of the other thirty-three jurisdictions in which it was taxable. Column three is the amount of the gain that was apportioned to, and taxable by, these thirty-three jurisdictions. This amount is calculated by (i) multiplying the gain on the sale of the plant by the aggregate apportionment percentage, and (ii) then subtracting that part of the gain that was not taxed by Ohio and South Carolina, multiplied by their respective apportionment percentages.[2] Column four is the amount of gain allocated to Delaware and is identical to Column one. Column five is the total gain on the sale of the plant that was taxable by Delaware and by the other thirty-three jurisdictions. It is the sum of columns three and four. Column six is the percent of the gain that was taxable by Delaware and by the other jurisdictions. The 187% in Column six demonstrates the amount of multiple taxation in this case.

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[1] Of the $14,004,480 gain on the sale of the Delaware PVC plant, Ohio and South Carolina excluded from taxation $4,224,226 and thus taxed $9,780,254 ($14,004,480 - 4,224,226 = $9,780,254) or 70% of the gain ($9,780,254/$14,004,480).

[2] See note 3, infra.

TABLE ONE
CALCULATION OF THE MULTIPLE TAXATION OF THE GAIN

(1)	(2)	(3)	(4)	(5)	(6)
Gain on sale of plant	Aggregate apportionment % (excluding Delaware)	Gain apportioned to, and taxable by, other jurisdictions[3] (1) x (2)	Gain allocated to Delaware (1)	Total gain taxable (3) + (4)	% of gain taxable in total (5)/(1)
14,004,480	94.5%	12,164,773	14,004,480	26,169,253	187%

B. Questions Presented

You have asked me as a consultant to numerous state governments, as the author of a text on state taxation and of over 60 publications, as a teacher of state taxation for nearly 25 years, and as someone knowledgeable about the tax laws of other states and the philosophy and normative principles informing these laws, to describe how Delaware law compares to the national pattern of state taxation.

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[3] If all of the $14,004,480 gain were apportionable, the column three amount would be $13,234,233 ($14,004,480 X .945). However, not all of the gain was apportionable by Ohio or South Carolina, so that this amount must be reduced. Ohio did not tax $4,224,226 of the gain. The taxpayer's 1989 Ohio apportionment percentage was .016042, so that the Column three amount must be reduced by $67,765 ($4,224,226 X .016042). South Carolina also did not tax $4,224,226 of the gain. The taxpayer's 1989 South Carolina apportionment percentage was .237131, so that the Column three amount must be further reduced by $1,001,695 ($4,224,226 X .237131). Accordingly, the Column three amount is $12,164,773 ($13,234,233 - $67,765 - $1,001,695).

Specifically, you asked: (1) whether Delaware law, which allocated all of the gain on the sale of the plant to Delaware, produced a disproportionate assignment of income; (2) whether as applied to the taxpayer, specific allocation reflected how income on the sale of the plant was generated; and (3) whether the State's rule in this case produced a situation in which the taxpayer's gain on the sale of the plant was subject to multiple taxation.

C. Analysis

1. An overview of the consensus rules on the taxation of multistate corporations

All states with a corporate income tax must determine their proper share of the tax base of a multistate corporation. Nearly all states – but not Delaware – have adopted similar approaches. In general, these states all use a formula to apportion a corporation's business income (operational income) among those states in which it is doing business.

Many states use rules of specific allocation to assign *nonbusiness* income (investment income). An example of nonbusiness income would be gain on the sale of a discrete, passive investment that was independent of, and unrelated to, a corporation's regular course of business. Unlike formulary apportionment, which shares a corporation's business income among the states in which it is doing business, specific allocation assigns categories of nonbusiness income in their entirety to a specific state.

In some general respects, Delaware's rules resemble those used throughout the United States. Delaware uses both formulary apportionment and specific allocation. A critical difference, however, is that Delaware's rules on

specific allocation do not distinguish between business and nonbusiness income. For example, unlike most states, Delaware's rule on the allocation of gain on the sale of tangible or real assets applies regardless of whether such gain constitutes business income. Under this rule, all of the gain on the sale of the taxpayer's PVC plant was allocated to, and taxable in full by Delaware. That the assets were part of the taxpayer's business was irrelevant under the Delaware statute whereas in many states in which the taxpayer filed returns that fact led to the gain being included as part of the corporation's apportionable income.

The Delaware rule on the specific allocation of gain on the sale of Delaware assets reflects a very old philosophy of taxation. A rule that allocates gain to the state where the assets are located is based on the premise that the property is the source of the income; accordingly, the rule sources gain exclusively in the state in which the property is located. Nearly all states, however, including thirty-one jurisdictions in which Hoechst was taxable, have rejected this approach for assets that are part of the taxpayer's business. Ohio and South Carolina have also rejected this rule for recapture gain.

In my opinion, there are three reasons why most states have rejected the Delaware rule. First, most states have adopted the view that gain on the sale of an asset used in the business of a corporation to generate apportionable business income should not be assigned to only one state, any more than the business income the asset helped to generate prior to its sale should be assigned to only one state.

Second, a geographical allocation rule, such as Delaware's, might have the effect of undercutting a state's efforts at economic development because it discourages taxpayers from locating real and tangible assets in the state. Gain on the sale of those assets will be taxed in full by the state in which they are located and are also likely to be taxed in the other states in which the corporation is doing business. Consequently, multiple taxation will result. Indeed, as the facts of this case illustrate, by locating its plant in Delaware, the taxpayer was taxed on 187% of the gain on the sale of the tangible assets of the plant. If however, the plant had been located in one of thirty-one jurisdictions in which it conducted business, the taxpayer would have been taxed on less than 100% of the gain. Accordingly, a state might fear that a geographical allocation rule, such as Delaware's, would have the effect of encouraging taxpayers to locate their operations in other states.

Third, a geographical allocation rule, such as Delaware's, discriminates in effect against multistate corporations that sell tangible assets located in a state. An intrastate corporation that conducts all of its business in Delaware will be taxable on 100% of the gain on the sale of its tangible assets. In sharp contrast, a multistate corporation that sells tangible property located in Delaware will be taxable on 100% of any gain by Delaware and will also be likely to have that same gain taxable by the other states in which it is doing business, as was true in this case. My experience has been that most states try to avoid rules that discriminate in effect against interstate corporations.

2. Exculpatory and relief provisions

The consensus rules of apportionment and allocation described above that are used throughout the country (but not in Delaware) are mechanical approaches that have evolved over time to deal with the everyday operations of manufacturing and mercantile corporations. One of the virtues of the rules is that an overwhelming majority of states have agreed to use essentially the same basic pattern of taxation.

In mainstream situations, such as the taxation of the everyday profits of an integrated manufacturing operation, the general practice of nearly all the states, including those in which Hoechst was taxable in 1989, is to use formulary apportionment. Apportionment works satisfactorily and produces results that comport with the principles of a good tax system. For example, apportionment minimizes situations in which a multistate corporation is taxable on more than, or less than, 100% of its income. The apportionment rules are neutral and neither discriminate against nor favor interstate corporations. A goal is to provide a level playing field to help ensure that multistate corporations competing with one another and with intrastate corporations are taxable on all of their income. Moreover, uniformity in the rules reduces the influence that tax considerations will have in where a plant is located.

In a complex economy with diverse businesses and transactions, however, the standard mechanical rules of formulary apportionment and specific allocation cannot be expected always to work well. States recognize that slavish devotion to the general rules can produce inappropriate results and consequently, that the mechanical rules

will often need to be adjusted to deal with special situations of distortion. Accordingly, states provide for a general relief or exculpatory provision, which allows the general rules to be superseded by the tax administrator.

In this respect, Delaware law is typical of that of many states. Delaware provides that if in the discretion of the Secretary of Finance, the application of the allocation or apportionment provisions results in an unfair or inequitable proportion of the taxpayer's entire net income being assigned to Delaware, the Secretary or his delegate may permit or require any other method to produce a fair and equitable result. These equitable relief statutes are applied by the tax administrator to a specific set of facts on a case-by-case basis. In my experience, the relief statutes are intentionally open ended to provide the tax administrator with the flexibility needed for dealing with specific situations that were not addressed by the Legislature.

3. Application of the Delaware relief provision to the taxpayer

This case raises the proper interpretation of the Delaware relief provision. Two different aspects of the relief provision are implicated. First, while a state's mechanical rules work best for the plain vanilla type of situation, this case involves an event that is unusual in the life of a business, the sale of a plant. Out-of-the-ordinary situations like the sale of a plant trigger the exculpatory rule and require that the Secretary interpret and apply it judiciously to eliminate inappropriate and improper results.

Second, Delaware has a rule on the specific allocation of gain on the sale of property that few other states use.

This rule can lead to the multiple taxation of more than 100% of the gain, as was true in this case. Furthermore, this multiple taxation affects only multistate corporations and not intrastate corporations. The rule thus discriminates in effect against interstate corporations. This case presents the issue of whether the Secretary should use his discretion to reduce, if not eliminate, this multiple taxation and discrimination.

a. Allocating all of the gain on the sale of the plant to Delaware produces a disproportionate assignment of income

What constitutes a disproportionate assignment of income under the facts of this case can be determined by examining how Delaware and the other thirty-three jurisdictions in which Hoechst filed returns, taxed the operational income of the taxpayer, including the income of the Delaware plant. During all the years in which the taxpayer owned and operated the Delaware plant, the State did not specifically allocate the income of the plant to Delaware, notwithstanding that the plant was located there. Indeed, no state uses such an approach. Instead, Delaware, like all states, apportioned the income of the plant to the states in which the taxpayer did business.

Formulary apportionment, unlike specific allocation, recognizes that because the plant is part of the taxpayer's integrated manufacturing operation, its income is not attributable only to activities taking place in Delaware. In an integrated manufacturing business, there are synergies, interdependencies, and mutual contributions among the various segments of the taxpayer's business. The whole is greater than the sum of the parts and the Delaware operations are more valuable because of all of the

taxpayer's activities, including those taking place in other states. Formulary apportionment recognizes that a corporation's nationwide activities contribute to the production of its income and that its income should be shared among all the states in which the taxpayer does business.

In sharp contrast to its use of formulary apportionment for assigning the taxpayer's operating income, Delaware law treats the sale of the Delaware plant as generating gain allocated in full to the State. Yet the value of the plant reflects the present value of what would otherwise be the operational income of the plant. If formulary apportionment is accepted both nationally – and in Delaware – as the correct method of apportioning the operational income of the plant, then it is the correct method of apportioning the discounted present value of that operational income.

Put differently, if specific allocation were viewed as an acceptable rule for taxing the discounted present value of the operational income of the plant, then it would follow that it would also be the acceptable method for taxing the income generated by the plant. Yet neither Delaware, nor any other state, views specific allocation as an acceptable method for taxing the income of a plant.

Formulary apportionment is designed to share the tax base of a multistate corporation in an acceptable manner among the states in which it is doing business. Formulary apportionment is intended to divide up a corporation's operational income so that each state can tax its proportionate share. Relief provisions allow a tax administrator to produce a proper assignment of income in special situations.

b. As applied to the taxpayer, specific allocation does not reflect how gain on the sale of the plant is generated

The PVC plant in Delaware was not a passive, discrete investment by the taxpayer divorced from the rest of its business. The PVC plant was an active part of an integrated, multistate manufacturing business. The PVC plant had proven value because of its relationship to the rest of the taxpayer's interstate business. Allocating all of the gain on the sale of the plant to Delaware disregards the relationship of the plant to the taxpayer's integrated multistate business and leads to distortion.

The rules of any state tax system must reasonably reflect how income is earned. If they do not, the rules produce unreasonable and arbitrary results. A rule that allocates gain on the sale of an asset entirely to one state would be reasonable if the asset had no relationship whatsoever to activities conducted by the seller in other states. For example, if a multistate manufacturing corporation held undeveloped land in Delaware as a passive, discrete investment unrelated to its business, specific allocation would produce a reasonable assignment of income because no other state would have a legitimate claim to tax the gain. But because the plant was an integral part of the taxpayer's manufacturing operation, allocating all of the gain on its sale to Delaware does not reasonably reflect how that income was earned.

c. As applied to the taxpayer, specific allocation of the gain on the sale of the plant leads to multiple taxation

A determination of whether Delaware's rules on allocation reach a disproportionate assignment of income cannot be made in isolation. Delaware is just one of the thirty-four jurisdictions that have taxed Hoechst. Whether Delaware's rules reach a disproportionate assignment of income must take into account how these other jurisdictions have taxed the same income that Delaware is allocating in full to itself.

The rules adopted nationwide by nearly all states are intended to, and have the effect of, minimizing the multiple taxation of multistate corporations. Formulary apportionment is used to apportion business income among the states in which a corporation does business. Nonbusiness income, which is not subject to formulary apportionment, is generally allocated to one state. This general pattern helps ensure that a multistate corporation is taxable on 100% of its income: its business income is divided up among the states in which it does business and its nonbusiness income is assigned to one state. No distortion in the assignment of income results.

Delaware's taxation in full of the taxpayer's gain on the sale of its Delaware plant frustrates this goal and creates an asymmetry that departs from the national framework of state taxation. With the exception of Ohio and South Carolina, the gain on the sale of the Delaware plant was included in apportionable income by the taxpayer in every other jurisdiction in which the Hoechst was taxable. (Ohio and South Carolina did not tax the economic gain attributable to the Delaware real property.) In the year of the sale, the taxpayer apportioned 87% of the

gain on the sale of the plant to the jurisdictions in which it filed returns. By allocating all of the same gain to itself, the Delaware rule ensured that the taxpayer was taxed on 187% of the gain. See Table One above. An intrastate corporation selling a plant would have been taxed on only 100% of the gain.

The 187% taxation of the taxpayer's gain does not result from the interaction of a mainstream approach to taxation by Delaware with that of another state. This is not a case, for example, where the overtaxation resulted from the interaction of Delaware's rules on formulary apportionment with another state's rules on formulary apportionment. Rather, the 187% taxation in this case arises from the application of formulary apportionment by every other jurisdiction in which the corporation is taxable and Delaware's minority position on the allocation of gain. By allocating all gain on the sale of assets located in Delaware to itself, regardless of whether the assets were used to generate apportionable income, Delaware's rule is inconsistent with those of the other thirty-three jurisdictions in which the taxpayer filed returns.

No other state acting in isolation can solve the multiple taxation problem because it did not create the problem. The problem was created by Delaware's special rule that clashes with those used elsewhere. Under the facts of this case, the rule produces multiple taxation for interstate corporations but not for intrastate corporations. The rule thus has the effect of discriminating against interstate corporations. In my experience, multiple taxation and its disproportionate and discriminatory effect on multistate corporations are not goals of a tax system that should be encouraged and pursued. The Secretary can eliminate these undesirable consequences, not by adopting an

unprecedented or unique method of taxation, but merely by apportioning the gain on the sale of the plant as was done in the other thirty-three jurisdictions.

D. Conclusion

Allocating all of the gain on the sale of the Delaware plant to Delaware produces a disproportionate assignment of income. First, allocating all of the gain to Delaware treats that State as if it were the exclusive source of the income on the sale. But the gain on the sale of the assets of the Delaware plant can not be viewed as sourced entirely in Delaware. The plant was part of an integrated manufacturing operation and its value reflected the nationwide activities of the taxpayer.

Second, the sales proceeds reflect the present value of the future operational income of the plant. All states, including Delaware, properly view the operational income as being apportionable to the states in which the taxpayer is doing business. No state would consider the operational income as being appropriately assigned in its entirety to Delaware, yet that is essentially the position of the State in this case.

Third, the State's position in this case results in 187% of the gain being taxed and has a disproportionate and discriminatory effect on a multistate corporation, such as Hoechst. This multiple taxation and discrimination arise because Delaware has adopted a rule that deviates from the national pattern of taxation and is out-of-step with all the jurisdictions in which the taxpayer filed returns. By adopting a special rule, Delaware has created a situation whereby its approach clashes with the national consensus

view as to what constitutes a proportionate assignment of income.

E. Qualifications

My qualifications are set forth in the curriculum vitae attached as Exhibit A. Exhibit B lists my most recent testimony in state tax litigation. My consultantships involving state tax matters are listed on my curriculum vitae.

/s/ Richard D. Pomp
Richard D. Pomp

Feb. 13, 1997
Date

APPENDIX H

KPMG Peat Marwick LLP

Report on Delaware Corporate Income Tax Treatment of Sale of PVC

HOECHST CELANESE CORPORATION

v.

DIRECTOR OF REVENUE, DEPARTMENT OF FINANCE, DIVISION OF REVENUE

Delaware Tax Appeal Board Docket No. 1166

February 3, 1997

I. Introduction and Background

From 1968 through 1989, Hoechst Celanese Corporation (Hoechst) owned property, known as its PVC Film Division plant (PVC), in Delaware. During the period Hoechst owned PVC, it claimed depreciation deductions related to PVC in calculating its federal taxable income. During these same years, Hoechst filed numerous state income tax returns. In apportioning its net income, Hoechst received a pro rata state tax benefit from the annual depreciation deductions in each state it filed an income tax return, including Delaware. The federal income tax depreciation deductions claimed by Hoechst throughout the period it owned PVC totaled approximately $31.5 million. As a result of apportionment, the portion of this depreciation that was actually deducted in Delaware (from an economic perspective) and that produced a Delaware tax benefit, was approximately $1.3 million (approximately four percent of the total federal tax deduction). The

Delaware tax benefit derived by Hoechst from its apportioned depreciation deductions on PVC was $118,664.

In 1989, Hoechst sold PVC for a gain of $14 million. Pursuant to Internal Revenue Code (IRC) §§ 1245 and 1250, Hoechst treated a portion of the gain ($9.9 million) attributable to past depreciation deductions as ordinary income (hereinafter the "recapture income"). The remaining portion of the gain ($4.1 million) was classified as capital gain pursuant to IRC §1231.

On its originally filed Delaware Corporate Income Tax return for the taxable year ending December 31, 1989, Hoechst allocated the full depreciation recapture income of $9.9 million to Delaware pursuant to 30 Del. C. §1903(b)(3) and paid tax on the sale of PVC in the amount of $861,624. However, Hoechst also paid tax of $649,030 to 33 other taxing jurisdictions on the sale of PVC. Recognizing the inherent impropriety of Delaware's taxing scheme, Hoechst later filed an amended Delaware return apportioning the recapture income and claiming a refund of $817,166.

The Division of Revenue (the "Division"), citing 30 Del. C. §1903(b)(3), denied the refund claim. Should the Department's position prevail, Hoechst would pay tax on the sale of PVC to substantially all of the states in which it does business, and again to the state of Delaware. Further, Hoechst would be required to pay Delaware tax of $861,624 to recapture expenses that only produced a Delaware tax benefit of $118,664.

II. Summary

Delaware required Hoechst to apportion its PVC depreciation deductions but allocated the entire recapture income on the PVC sale to Delaware, subjecting the entire income to Delaware corporate income tax. Delaware's application of its statute, 30 Del. C. §1903(b)(3), does not appropriately match Hoechst's income with its expenses, thus contravening fundamental principles of economics, financial accounting, and federal income tax accounting principles.

Economic principles require that the costs and expenses associated with an asset and the benefits derived from the asset be matched in order to adequately depict the economic reality of the ownership, operation, and sale of the asset. Delaware's treatment of the PVC sale contravenes the basic economic principle of matching.

Generally Accepted Accounting Principles (GAAP) require that related items of income and expense be matched. The proper matching of income and expenses may span one or several accounting periods. In addition to GAAP, numerous federal income tax principles are premised on the proper matching of income and expenses. Provisions containing the matching concept are pervasive throughout the Internal Revenue Code (IRC), impacting income and expense recognition, accounting methods, and other areas. The Delaware tax structure requiring apportionment of deductions and allocation of related income contravene the fundamental principle of matching contained in federal income tax accounting principles and is wholly inconsistent with Delaware's tax base conformity to federal taxable income.

If Delaware's purpose is to avoid mismatching of Hoechst's income and expenses, Delaware should not tax the entire federally determined recapture income on the sale of PVC. Rather, Hoechst should apportion the recaptured income just as it apportioned the related PVC depreciation expense deductions. Taxing the entire PVC recaptured income results in mismatching of Hoechst's income and expenses.

III. Discussion

Established economic principles, federal income tax principles, and generally accepted accounting principles demand that comparable methodologies be employed to report expenses related to an asset and income derived from that asset. The concept of matching is a foundational concept of these three disciplines.

A. The Economic Principle of Matching

Matching of costs and benefits is a fundamental economic principle that must be applied to all transactions. In particular, the costs of an asset generating a benefit must be matched to the benefit provided by the asset to adequately depict the economic reality of the ownership, operation, and disposal of the asset. This is equally true whether one is analyzing the use of an asset or its sale.

The economic concept of depreciation is a good example of this type of matching – it allows one to match the benefits of an asset, which are received over its useful lifetime, to an amortized stream of costs over the same time period. Calculating economic rates of return is another example – a rate of return is only meaningful economically if the

benefits stream in the numerator matches (or derives from) the assets in the denominator. This is why it would be inappropriate to calculate a rate of return as (for instance) operating income (*i.e.*, the return or benefit from non-financial assets only, not including interest or dividends from financial assets) divided by total (financial and non-financial) assets. Comparisons based on the inappropriate rate of return would be biased against any company that had significant amounts of financial assets, since these assets would be included but their benefits would be omitted. Similarly, since the depreciation benefit that Hoechst has received in Delaware has been just four percent of the total depreciation, calculations of recapture income for Delaware income tax purposes can only allocate this amount of depreciation to the determination of the basis for the gain in Delaware. There are, therefore, only two economically appropriate approaches to depict Hoechst's sale of PVC in calculating recapture income for Delaware corporate income tax purposes: (1) compare 100 percent of the sales price of PVC to a basis that incorporates 100 percent of the cost of PVC reduced by the four percent allocation of depreciation that Delaware has allowed Hoechst to deduct in past taxable years; or (2) compare four percent of the sale price of PVC to a basis that incorporates four percent of the cost reduced by the four percent of depreciation that Delaware has allowed. Thus, economic principles clearly require that the taxpayer's gain on sale of PVC (for Delaware corporate income tax purposes) must recapture only those depreciation deduction benefits that Delaware has permitted in the past. Calculating the basis using 100 percent of the depreciation when only four percent was allowed as a deduction results in an estimation of the benefit of the transaction

that is larger than the true total economic benefit. This result is economically nonsensical.

B. Generally Accepted Accounting Principles (GAAP)

1. Financial Accounting Standards Board (FASB) Statements

The FASB issues Statements and Interpretations in the area of financial accounting. (Generally Accepted Auditing Standards (GAAS) Guide, Larry P. Bailey, Ph.D., CPA, Harcourt Brace Publishing, 1997, p. 3.12). These FASB Statements are accorded significant weight in determining appropriate accounting methods and treatment. Each new FASB Statement is preceded by an Exposure Draft that identifies and analyzes the issues under consideration. (GAAS Guide, 3.12). A FASB Statement establishes new, or modifies existing, GAAP. (GAAS Guide, 3.12). The following FASB Statements of Concepts illustrate the significance of matching expenses and revenues.

2. Recognition, Matching, and Allocation

The matching concept is a basic principle of GAAP. GAAS Guide, 3.04. The matching concept requires that revenue and related costs be matched in determining the timing and amount of net income for a specific period. GAAS Guide, 3.05. In addition, where revenue is deferred to a future period, the associated costs of the revenue must also be deferred. GAAS Guide, 3.05. Often, to achieve a proper matching, it is necessary to estimate revenue and/or costs. GAAS Guide, 3.05.

GAAP and financial statement accounting principles are replete with examples of the fundamental principle of

matching costs and revenues, both in amount and in the proper period. For example,

> "Matching of costs and revenues is simultaneous or combined recognition of the revenues and expenses that result directly and jointly from the same transactions or other events. In most entities, some transactions or events result simultaneously in both a revenue and one or more expenses. The revenue and expense(s) are directly related to each other and require recognition at the same time." Concepts Statement 6, ¶146.

Concepts Statement 6, ¶146 explicitly requires the actual matching of income and expenses in both timing and amount. Furthermore, matching requires that revenues and associated costs are matched over the course of one or more periods:

> "Many assets yield their benefits to an entity *over several periods*, for example, prepaid insurance, buildings, and various kinds of equipment. Expenses resulting from their use are normally allocated to the periods of their estimated useful lives (the periods over which they are expected to provide benefits) by a 'systematic and rational' allocation procedure, for example, by recognizing depreciation or other amortization." [Emphasis added.] Concepts Statement 6, ¶149.

Thus, GAAP requires that revenues and costs incurred to generate revenues are matched in the appropriate period or periods. Without the matching requirement, costs of acquiring long-term fixed assets would be deducted in the period the costs were incurred, rather than the period in which the costs provided a benefit. Matching costs to the

appropriate periods prevents the distortion of income and prevents taxpayers from manipulating income recognition.

3. Systematic and Rational Approach

As noted above, matching is accomplished using a systematic and rational approach. Systematic and rational matching procedures are required in several GAAP tenets, and require that the timing and amount of the costs rationally relate to the timing and amount of the benefits provided.

> "Consumption of benefits during a period may be recognized either directly or by relating it to revenues recognized during the period. Some expenses, such as depreciation and insurance, *are allocated by systematic and rational procedures to the periods during which the related assets are expected to provide benefits.*" [Emphasis added.] Concepts Statement 5, ¶86: Consumption of Benefits.

Hoechst utilized a systematic and rational allocation procedure in apportioning the depreciation expenses among the states in which it did business. The GAAP concepts demonstrate that a similarly systematic and rational method should be used to apportion the appropriate amount of recapture income in the appropriate year. Delaware failed to adhere to the matching concept when it allocated the entire recapture income from the sale of PVC to Delaware, while denying Hoechst the full benefit of PVC depreciation deductions. Because the deductions were limited to a pro rata amount (determined in accordance with Hoechst's Delaware apportionment percentages), and the recapture income on the sale of PVC was taxed in full, a mismatching occurred. Thus, the Division's treatment of

depreciation deductions and recapture income is not systematic and rational.

4. Rationales for Matching

Accounting principles provide several rationales for matching costs of an asset with the periods in which the asset provides a benefit, including economic principles.

> "Expenses and losses are generally recognized when an entity's economic benefits are used up in delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations or when previously recognized assets are expected to provide reduced or no further benefits." Concepts Statement 5, ¶85: Expenses and Losses.

Thus, matching results in a sound economic portrayal of a transaction or transactions. Further, certain assets, such as fixed assets, provide benefits over several periods and therefore, are recovered in several periods through depreciation deductions. The matching principle provides the justification for assigning the costs of these assets to the periods the assets benefit. Thus, matching leads to sound financial accounting reporting and assists in reflecting the true economic reality of a transaction or enterprise.

C. Federal Income Tax Provisions

Matching income with expenses is a fundamental component of federal income taxation. The IRC is replete with provisions containing the concept of matching in various contests. In determining Delaware taxable income, Delaware starts with federal taxable income, determined in accordance with the IRC, with enumerated modification

adjustments. 30 Del. C. §1903(a). Delaware defines federal income tax as the tax imposed on corporations by the federal Internal Revenue Code of 1986 and amendments thereto. 30 Del. C. §1910(5). Therefore, unless Delaware explicitly alters the tax treatment of an item or the applicability of an IRC provision, the IRC is adopted in determining Delaware taxable income. As a result of Delaware's conformity to the IRC, federal tax accounting rules, including adherence to the matching principle, dictate the calculation of Delaware taxable income. Therefore, the following examples of IRC provisions illustrating the matching concept serve as fundamental analogies.

1. Income and Expense Provisions

As seen above, the matching of income and expenses is a fundamental component of GAAP. The IRC also contains numerous provisions that relate to the amount and timing of income and expenses. The following IRC sections exemplify that items of income are required to be matched with related expenses, whether within one accounting period or over several periods.

a. Depreciation (IRC §167)

Section 167 allows as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear of property used in the trade or business or held for the production of income.

"Depreciation is an accounting device which recognizes that the physical consumption of a capital asset is a true cost, since the asset is being depleted." *Commissioner of Internal Revenue v. Idaho Power Co.*, 418 U.S. 1 (1974).

Further, "[a]s the process of consumption continues, and depreciation is claimed and allowed, the asset's adjusted income tax basis is reduced to reflect the distribution of its cost over the accounting periods affected." *Id.*

The purpose of depreciation is to allocate the cost of an asset to the various periods which are benefited by that asset. *Hertz Corp. v. United States*, 364 U.S. 122, 126 (1960). The basis of an asset is adjusted to reflect depreciation deductions allowed or allowable. IRC §§1011, 1016. Accordingly, in determining the federal income tax on the sale of PVC, Hoechst was required to reduce its tax basis in PVC by the amount of depreciation claimed.

Delaware did not require Hoechst to separately calculate depreciation on PVC or a Delaware tax basis for PVC, but rather adopted the federal depreciation and basis calculations. Delaware required Hoechst to apportion the federal depreciation deductions in calculating Delaware taxable income. Consistency requires Delaware to permit Hoechst to apportion the recaptured income on the sale of PVC in a similar manner as the depreciation deductions were apportioned. Failure to do so violates the principle of matching revenue and expenses, and results in a gross overstatement of income attributable to Delaware.

b. Recoveries of Damages (IRC §186)

Section 186 allows a taxpayer that recognizes an estimated amount of damages as income to take a corresponding deduction if the actual award is less than the estimation. Section 186 incorporates the matching principle by permitting a taxpayer to deduct the excess of the estimated recovery over the actual recovery. This provision provides an additional example of the IRC that

attempts to correct a mismatching of the transaction and its tax affects. Thus, ignoring the past tax treatment of PVC's depreciation deductions and focusing exclusively on the recaptured income from the 1989 sale of PVC results in a mismatching of income and expenses. Hoechst received a pro rata depreciation deduction during the years it owned PVC. Therefore, Hoechst should be required to pay tax on only a pro rata portion of the recaptured income on the sale of PVC. Any other treatment would not result in the matching of the income and costs resulting from the ownership of PVC.

c. Source Rules for Personal Property Sales (IRC §865)

Section 865 provides that the income from the sale of personal property is determined under a residence-of-the seller rule. Generally, a sale by a U.S. resident is sourced to the U.S., and a sale by a non-U.S. resident is foreign-sourced. IRC §865(a). However, an exception is provided in the case of gain from the sale of depreciable property. IRC §865(c). The exception provides that gain is sourced to the U.S., to the extent of prior deductions, under a recapture provision. Further, if depreciation deductions have been allocated against U.S. or foreign-source income, then gain from the sale of depreciable property must be similarly sourced.

These sourcing provisions reflect the importance of matching a tax benefit (*i.e.*, tax depreciation deductions) with a tax detriment (*i.e.*, recaptured income) over time. Also, the section provides that the amount of the tax benefit and the tax detriment must mirror each other. The rules for sourcing multi-national income are instructive, by analogy, to

determine the proper sourcing of state taxable income. Therefore, section 865 provides insight for the state tax sourcing of gains from the sale of depreciable property. Section 865 attempts to ensure that a tax benefit in a jurisdiction (*i.e.*, allowed depreciation deductions) is matched with a tax detriment in the jurisdiction (*i.e.*, tax on the recaptured income resulting from the sale of the depreciated asset). Because Delaware allowed Hoechst to receive a pro rata portion of the benefit (*i.e.*, depreciation deductions) in Delaware, the matching principles of IRC §865, would, by analogy, dictate that the entire tax detriment (*i.e.*, tax on the recaptured income) should not be required to be allocated to Delaware. Delaware's imposition of tax on the entire recaptured income from the sale of PVC is at odds with the matching principle embodied in section 865 and throughout the IRC.

2. Accounting Methods

Federal income tax accounting contains several provisions regarding accounting methods that exemplify the importance of matching.

a. Percentage of Completion Method (IRC §§460(a) & (b))

The percentage of completion method (PCM) is an accounting method that applies to certain long-term contracts (a contract starting in one year and ending in another). The PCM generally allows taxpayers to recognize a portion of income on the contract over the course of the contract's life. A portion of the income is thereby recognized each year based on the contract's progress.

The PCM provides for the matching of income with associated expenses over the life of the contract. The PCM is another example of a systematic and rational procedure that matches the costs of an activity with the income the activity generates over multiple tax periods. Applying the matching methodology encompassed in the PCM, the recaptured income on the sale of PVC, with respect to both timing and amount, should be matched with the depreciation deductions generated during Hoechst's ownership of PVC.

b. Computation of Tax Where Taxpayer Restores Substantial Amounts Held Under Claim of Right (IRC §1341)

Section 1341 applies to a taxpayer who recognized income in a year when it appeared that the taxpayer had an unrestricted right to such income (the claim of right rule) and is later required to repay a portion of the income in a subsequent year. When the repayment of the income produces tax benefits that are less than the tax detriments originally suffered by the taxpayer, § 1341 rectifies the mismatching by providing for a reduction of tax in the year of repayment.

Section 1341 demonstrates that proper application of matching is not limited to revenue and expense recognition, but also ensures that the tax consequences of a transaction is matched to the true economics of the transaction. Thus, the provision ensures that the tax code is not applied blindly, but rather is imposed with a view of prior tax treatment in mind. This provision serves as an analogy to the way in which Delaware should view the PVC recaptured income consistently with the matching principle, and thus prevent mismatching the income from the sale of

PVC with the related expense deductions taken in the previous nineteen years. This approach would apportion the income just as Delaware required Hoescht to apportion the PVC depreciation deductions.

c. The Income Forecast Method

The income forecast method recognizes that certain assets generate uneven flows of income and have unique income producing potential such as television and movie films, taped shows for reproduction, book manuscripts, patents, master recordings, etc. Rev. Rul. 79-285, 89-62, and 95-52. The income forecast method may be applied to compute depreciation of these types of assets because the passage of time is often not an appropriate measure of the asset's useful life. Rev. Rul. 95-52. To properly apply the income forecast method, taxpayers must make income projections, and adjust the income forecast if it is found to be substantially overestimated or underestimated. Rev. Rul. 60-358.

The income forecast method is another example of the application of matching. This method attempts to guard against the over or under depreciating of an asset and reflects the significant importance placed on the matching of costs and income from the ownership of assets. Delaware's treatment of Hoechst's recaptured income does not reflect the matching of costs and income from the ownership of PVC. In determining the Delaware tax on the sale of PVC, if Delaware wishes to avoid mismatching of income and expense, it should not limit its analysis to the year of the sale, but should examine what tax benefits/detriments Hoechst recognized in Delaware over the course of its ownership of PVC.

2. Other Provisions

The IRC contains many other provisions that incorporate the concept of matching and which serve as a useful basis of comparison to Delaware's treatment of the recaptured income on the sale of PVC.

a. The Recovery of Tax Benefit Items (IRC §111)

The recovery of tax benefit items, often referred to as the tax benefit rule, does not require a taxpayer to include in income amounts previously deducted if the amount did not actually reduce the taxpayer's income tax liability. IRC §111(a). Further, the types of recoveries §111 relates to include amounts previously taken as itemized deductions, payments on previously deducted bad debts, and recoveries of items previously claimed as credits. The recovery must be directly related to the item previously deducted to qualify for exclusion under the tax benefit rule.

The tax benefit rule illustrates that the concept of matching must be applied over time. By analogy, if Delaware wishes to implement the matching principle, it should take into account the prorated tax benefit Hoechst was provided during its ownership of PVC in determining the tax detriment Hoechst should be required to bear in the year of the sale. The Division's treatment of Hoechst's recaptured income violates the tax benefit rule because the treatment ignores the Delaware tax benefits Hoechst derived from owning PVC (*i.e.*, pro rata depreciation deductions).

b. Deduction for Certain Unused Business Credits (IRC §196)

If a taxpayer has not used certain qualified business credits at the end of a proscribed period, the taxpayer is entitled to a compensating deduction in the first tax year the credits expire. IRC §196(a). This provision provides for a deduction in a subsequent tax year where the taxpayer was not permitted to deduct the costs eligible for the credit in the year the credit was reported.

Section 196 demonstrates the underlying concept of matching because the taxpayer is entitled to the benefit (*i.e.*, credit) equivalent to the detriment of the unexpired credits. Section 196 provides an additional example of the way in which the matching concept may extend through accounting periods to ensure tax benefits and detriments are appropriately matched.

By failing to apportion the recaptured amount, Delaware has, in effect, ignored 19 years of apportioned depreciation expense deductions. Thus, Delaware has required Hoechst to allocate the entire recaptured income from the sale of PVC to Delaware, although it allowed Hoechst only a pro rata tax benefit from the depreciation deductions taken in previous years. This results in a fundamental violation of the matching principle.

IV. Conclusion

Matching is a fundamental principle of economics, financial accounting, and federal income tax accounting principles. The Division's tax on the entire recaptured income from the sale of PVC results in the mismatching of income and expense. If Delaware wishes to avoid such a mismatching of Hoechst's income and expenses, it should not

be permitted to tax the entire recaptured income on the sale of PVC, but should allow Hoechst to apportion the recaptured income just as it apportioned the related PVC depreciation expense deductions. Such treatment of the depreciation recapture income would result in an appropriate matching of Hoechst's income and expenses from PVC, as required by tax, accounting, and economic principles.

V. Qualifications

My qualifications are as set forth in my Curriculum Vitae attached as Exhibit A.

/s/ Michael H. Lippman
Michael H. Lippman
Partner

Supreme Court, U.S.
FILED
SEP 12 2003
OFFICE OF THE CLERK

No. 02-1829

In The
Supreme Court of the United States

CNA HOLDINGS, INC.,
f/k/a HOECHST CELANESE CORP.,

Petitioner,

v.

DELAWARE DIRECTOR OF REVENUE,

Respondent.

On Petition For Writ Of Certiorari To The Supreme Court Of Delaware

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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BRIEF IN OPPOSITION

The Attorney General of the State of Delaware, on behalf of the respondent, the Director of Revenue, respectfully asks this Court to deny the petition seeking review of the judgment of the Supreme Court of Delaware.

OPINIONS BELOW

The opinion of the Delaware Supreme Court (Pet. App. 1a-11a) is officially reported at 818 A.2d 953. The January 9, 2002 opinion of the Delaware Superior Court (Pet. App. 12a-25a) is unreported. The February 9, 2001 decision of the Delaware Tax Appeal Board (Pet. App. 26a-35a) is unreported.

JURISDICTION

The judgment of the Delaware Supreme Court was entered March 21, 2003.[1] The jurisdiction of this Court is invoked under 28 U.S.C. §1257.

STATEMENT

In 1992, petitioner CNA Holdings, Inc., a multistate corporation, filed an amended state income tax return,

[1] Delaware appellate practice does not provide for any separate document known as a judgment. Instead, the Clerk of the state supreme court enters a docket notation based on the final paragraph of the written decision. *See* Del. Code Ann. tit. 10, §162 (Repl. 1999).

seeking a refund of more than $817,000. Respondent, the Director of Revenue, denied the refund, and after a hearing, the Tax Appeal Board ruled in the Director's favor. On appeal to the Superior Court, the decision was reversed, the court holding that the Director's reading of the statute led to an unreasonable result. On the Director's appeal, the Delaware Supreme Court reversed.

1. The State of Delaware imposes a corporate income tax, the tax being based on the corporation's federal taxable income. Under the scheme in place for nearly 50 years, income derived from an asset that can be readily identified with or attributable to a particular location is first allocated to the state in which the asset is located. Thus, patent royalties are allocated to the state in which the process is used or the item is made; gains or losses from the sale of real property and depreciable personalty are allocated to the state in which the property is located. The remainder of the corporation's net income is apportioned to Delaware according to a standard three-factor formula, premised on the percentage of the company's total asset values, wages, and gross receipts represented by its Delaware holdings and activities. Pet. App. 4a, 37a-40a.

a. In 1989, petitioner sold a chemical plant located in Delaware for approximately $26 million. For federal tax purposes, petitioner recognized a gain of slightly more than $14 million from the sale of the plant; $9.9 million was attributable to depreciation recapture and $4.1 million was characterized by petitioner as "economic gain," being the amount the plant had appreciated. Pet. App. 2a. Petitioner's federal adjusted gross income for 1989 was more than $120 million, and petitioner paid $1,224,075 in Delaware income tax, $1,218,390 representing the tax on

the sale of the plant. Pet. App. 3a. The return thus assigned to Delaware 11.6 percent of petitioner's entire income. Pet. App. 9a. Petitioner paid to other states nearly $650,000 in tax on the gain from the plant sale. Pet. App. 3a. Petitioner had also sold two other plants located outside of Delaware, but petitioner paid no Delaware tax on those sales, its Delaware tax return allocating the gain resulting from those sales to the other states.

In 1992, petitioner filed an amended Delaware tax return, seeking a refund of $817,166. The amendment removed the $9.9 million in depreciation recapture from the non-apportioned income allocated solely to Delaware and added it to the apportionable income. The amendment also apportioned to Delaware a small part of the depreciation recapture attributable to the sale of the two other plants that the original return had allocated to the other states.[2] Pet. App. 3a. The amended return thus assigned to Delaware 3.88 percent of petitioner's total net income. Pet. App. 9a. Respondent concluded that petitioner's treatment of the depreciation recapture was not authorized by state law and denied the claim. Pet. App. 3a.

b. Protesting respondent's denial of its refund claim, petitioner appealed to the Tax Appeal Board. Before the Board, petitioner complained that the allocation statute assigned an unfair amount of its net income to Delaware. Pet. App. 26a, 31a. Two witnesses testified before the Board for petitioner and the Director testified for the Division of Revenue. Pet. App. 29a-30a. The Director

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[2] The Delaware apportionment factor for 1989 was 1.12%. Pet. App. 45a.

testified that in 1989, more than 1000 corporate taxpayers had allocated gains and losses from the sale of real and depreciable personal property. Those taxpayers had allocated to Delaware $30 million in gains and $500,000 in losses; the amount allocated to other states totaled some $6.2 billion in gains and $500 million in losses. App. 5.[3] The Board affirmed respondent's decision, holding that the statute was unambiguous and petitioner's reading of the statute was contrary to the plain meaning of the text. Pet. App. 34a. Petitioner's original return for 1989 had reported gross receipts from sales and other income in Delaware of nearly $23 million and had allocated to other states nearly $78 million, out of a total federal taxable income of over $120 million. Pet. App. 28a. The Board found that the Delaware tax benefits accruing to petitioner because of depreciation deductions on the plant in earlier years amounted to $118,664 and, using average tax rates, the tax benefit to petitioner in other states came to $1,845,796, for a total of $1,964,460. App. 2. The total tax paid by petitioner in all states, including Delaware, on the depreciation recapture under the amended return would be over $1.5 million, leaving an unmatched tax benefit to petitioner of $453,746. App. 2. Even if Delaware allocated both the "economic gain" accruing from the sale of the plant and the depreciation recapture, with other states apportioning the recapture income, petitioner still had a tax benefit of approximately $97,000. When the income subjected to Delaware tax was considered in the context of petitioner's entire net income, the amount of tax stemming

[3] The Director's proposed findings of fact were adopted by the Board. Pet. App. 30a.

from the business conducted in Delaware, including the sale of the plant, was not unreasonable. Pet. App. 34a-35a.

c. On appeal to the Superior Court, the court reversed the Board's decision. Focusing on the word "gains" in the statute, the court concluded that taxing 187% of the proceeds of the sale of the plant, because of the almost double taxation of the recapture component of the gain, was an unreasonable result. Thus, despite the plain text of the statute, the court read the word "gain" to mean only the amount the plant appreciated over time plus the tax benefit of depreciation claimed on prior Delaware returns. In the court's view, this interpretation resulted in a tax liability that was consistent with the majority of the states' approach to apportionment of business income. Pet. App. 20a-23a.

d. The Delaware Supreme Court, on the Director's appeal, reversed. First, because the state tax "'piggybacks' on the federal corporation tax, . . . it follow[ed] that the definition of 'gains' for Delaware tax purposes is the same as the definition of 'gains' for federal tax purposes." Pet. App. 8a. Because for federal tax purposes, "gains" included both what petitioner labeled "economic gain" and depreciation recapture, the Delaware statute similarly included both. In that light, the statute was unambiguous.

The court then turned to whether the plain reading of the statute led to an unreasonable result. The lower court had erred when it looked at the statute in a piecemeal fashion. Instead, the correct inquiry depended on the total amount of petitioner's income that is taxed in Delaware based on the business conducted in Delaware. Pet. App. 8a. The record before the court showed that in 1989, Delaware had taxed 11.6 percent of petitioner's federal

taxable income; under the amended return, the state would tax 3.88 percent. Pet. App. 9a. Petitioner did not present any evidence about the amount of income actually attributable to Delaware activity. Pet. App. 9a; App. 4. Instead, petitioner had only pointed out that under the statutory formula employed by a majority of states, petitioner's tax would be less. According to petitioner's experts, who had testified before the Tax Appeal Board, the business – non-business apportionment formula used by a majority of states more correctly approximated the amount of income that should be attributable to Delaware. Pet. App. 9a. But the evidence showed that petitioner had actually obtained a tax benefit of over $450,000 when one compared the tax savings coming from depreciation deductions on the plant to the tax imposed on the recapture of the depreciation upon the sale of the plant. Given this result, the court was unable to say that the statute had operated in an unreasonable manner. Pet. App. 9a-10a. Because petitioner had not shown that the statute led to an unreasonable outcome, the court then concluded that petitioner had "not met its burden of proof in challenging the constitutionality of the statute, as there [had] been no showing that [petitioner's] Delaware tax [was] out of all proportion to its business activities in Delaware." Pet. App. 10a.

REASONS FOR DECLINING REVIEW

Delaware imposes on corporations doing business within the state an annual income tax. It does so on a separate company basis instead of the unitary business concept in use by most states. Under this Court's jurisprudence, a state tax levied upon multistate businesses is

valid under the Commerce Clause "so long as 'the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.'" *Trinova Corp. v. Michigan Dep't of Treasury*, 498 U.S. 358, 372 (1991) (quoting *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977)). To successfully challenge a state tax, the taxpayer must "prove 'by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportion to the business transacted . . . in that State" [citation omitted] or has "led to a grossly distorted result."'" *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 170 (1983) (quoting *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978)). Petitioner did not meet that burden, and the tax imposed in this case satisfies the Commerce Clause.

1. Petitioner's initial contention is that the tax is not fairly apportioned. Pet. 11-12. The first component of fair apportionment is "internal consistency – that is the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business's income being taxed." *Container Corp. of America*, 463 U.S. at 169. The second aspect of fair apportionment is "external consistency – the factors used in the formula must actually reflect a reasonable sense of how income is generated." *Id.* If the tax is reasonably limited to in-state business in light of the practical effects on interstate activity, the tax is externally consistent. *Goldberg v. Sweet*, 488 U.S. 252, 262 (1989).

Delaware's tax scheme, using both geographical or transactional accounting and formula apportionment, but without using the unitary business concept, satisfies the

consistency tests. Though geographical allocation might ignore or not capture many subtle and largely unquantifiable transfers of value within an enterprise,[4] it does limit the reach of the tax to only income having its source in Delaware. It is obviously internally consistent because the income can only be assigned to a single state. Allocating the gain attributable to the sale of the Delaware plant to Delaware and allocating all of the gain from the sale of plants in other states to those states (even if depreciation attributable to those facilities had been previously taken against Delaware income) limits the tax exactly to the Delaware components of the interstate business. The remainder of the unallocated income is apportioned, and Delaware's three-factor formula for doing so is consistent with tax schemes approved by this Court. *See Trinova Corp.*, 498 U.S. at 380-82; *Container Corp. of America*, 463 U.S. at 170.

Petitioner also argues that the Delaware tax scheme discriminates against interstate commerce. Pet. 13-15. In the context of interstate commerce, the anti-discrimination principle has not added much to the requirement of fair apportionment. *Container Corp. of America*, 463 U.S. at 171. Petitioner's "'discrimination' claim is simply a way of describing the potential consequences of the use of different formulas by the [several] States. These consequences, however, could be avoided by the adoption of any uniform rule; the 'discrimination' does not inhere in [any] State's formula." *Moorman Mfg.*, 437 U.S. at 277 n.12.

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[4] *Container Corp. of America*, 463 U.S. at 164-65.

The Court has rejected arguments that the Commerce Clause requires uniformity in tax schemes. Eliminating the risk of duplicative taxation would require a single constitutionally mandated method of taxation and rules regarding the application of the method in particular cases. *Id.* at 277-79. But the Court in *Moorman Mfg.* declined to adopt that reading of the Commerce Clause: not only would it "require extensive judicial lawmaking," *id.* at 278, but the prevalent practice would become the constitutional rule, an "especially unsettling [prospect] if a longstanding tax policy in one State, such as [Delaware's], becomes the object of constitutional attack simply because it is different from the recently adopted practice of its neighbor." *Id.* at 280 n.16. *See Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 444-45 (1980) (finding "no adequate justification" for a "constitutional preference for one method of taxation over another").

2. The Delaware Supreme Court decided that petitioner had "not met its burden of proof in challenging the constitutionality of the statute" because petitioner had not shown that its Delaware tax was "out of all proportion to its business activities in Delaware." Pet. App. 10a. That holding by the state court is subject to substantial deference by this Court. *Container Corp. of America*, 463 U.S. at 175-76 (citing *Norton Co. v. Dep't of Revenue*, 340 U.S. 534, 538 (1951)).

a. Petitioner's claim of multiple taxation rests upon the reports and testimony of two witnesses, Richard Pomp and Michael Lippman. *See* Pet. App. 49a-82a. Pomp's opinion was based solely upon a separate analysis of the sale of the Delaware plant and only considered the treatment of that single item of gain by Delaware and the other states. Pomp did not analyze the portion of

petitioner's income that the statute assigned to Delaware in the context of petitioner's entire income. In fact, Pomp, testifying before the Tax Appeal Board, rejected that kind of analysis as irrelevant. App. 4. His analysis did not consider the fact that Delaware law allocated outside of Delaware some $77.9 million of business income that would normally be taxed by the states utilizing the typical apportionment formula when he concluded that Delaware disproportionately assigned income from the sale of the plant. App. 4.

Lippman testified from an accounting perspective as opposed to a tax perspective. He said from an economic point of view that Delaware could tax some $118,000 of the recapture based upon the value of the Delaware tax benefit from depreciation deductions attributable to the Delaware plant. But Lippman did not extend that "matching" treatment to the depreciation deductions attributable to plants and property outside of Delaware that petitioner had claimed as deductions on Delaware returns during the ownership period. App. 5-6. Accounting systems, "though useful and necessary as a business aid," do not appreciably aid the analysis; a State has very different requirements when it seeks to place upon a business extending into several states its fair share of the burden of taxation. *Butler Bros. v. McColgan*, 315 U.S. 501, 507 (1942) (citing *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 121 (1920)).

b. When petitioner complains it is being subjected to multiple taxation or to taxation of 187% of gain, it is only gain from the isolated sale of a single asset – the Delaware plant. Petitioner does not claim that more than 100% of its income was subjected to tax. That focus on an isolated business transaction is too narrow. *See Trinova Corp.*, 498

U.S. at 374-75 ("Trinova errs in the opposite direction. It would dissect the tax base as if the SBT were three separate and independent taxes. . . . "). But the issue is not whether an overlap in taxation exists because of the use of different, but acceptable, formulas for dividing a corporation's income;[5] instead, the question is whether Delaware has assigned to itself more income than it constitutionally can, taxing income earned outside its borders.[6] Before the Tax Appeal Board, petitioner made no effort to show the correct amount of income that should be assigned to Delaware based upon the business conducted there. App. 4. That shortcoming, as the Delaware Supreme Court decided, was fatal to petitioner's case, a point made by this Court in *Moorman Mfg.*, 437 U.S. at 276-77. The most that petitioner established was that if a different formula is used, a different tax – and in petitioner's case, a lower tax – would result. The fact that the tax might be lower is of no constitutional significance. Instead, petitioner had to show, by "clear and cogent evidence," that its alternative method was a more correct or more accurate measure of the business done in Delaware. *E.g., Trinova Corp.*, 498 U.S. at 384; *Moorman Mfg.*, 437 U.S. at 275 & n.9. Given petitioner's failure to make that showing, petitioner has not overcome the substantial deference due the Delaware Supreme Court's finding. *Trinova Corp.*, 498 U.S. at 384; *Moorman Mfg.*, 437 U.S. at 274; *Underwood Typewriter Co.*, 254 U.S. at 121.

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[5] *See, e.g., Trinova Corp.*, 498 U.S. at 373-74; *Container Corp. of America*, 463 U.S. at 181-83; *Moorman Mfg.*, 437 U.S. at 278-79.

[6] *E.g., Butler Bros.*, 315 U.S. at 506; *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 134-35 (1931).

3. Petitioner urges that the writ should be granted to resolve conflicting decisions on the point among the state courts. Pet. 15-19. In light of petitioner's evidentiary failure before the Tax Appeal Board and thus its failure to meet the burden of proof imposed by this Court's decisions, the resolution of any conflict is irrelevant to the ultimate outcome. As a result, the question posed by petitioner does not merit further consideration. *See Board of Educ. v. McCluskey*, 458 U.S. 966, 972 (1982) (Stevens, J., dissenting); *Boag v. MacDougall*, 454 U.S. 364, 366 (1982) (O'Connor, J., concurring); *id.* at 368 (Rehnquist, J., dissenting).

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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September 2003

BEFORE THE TAX APPEAL BOARD

FOR THE STATE OF DELAWARE

HOECHST CELANESE CORPORATION	)	
Petitioner,	)	
v.	)	Docket No. 1166
DIRECTOR OF REVENUE,	)	
Respondent.	)	

PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

A hearing was held in the above captioned and numbered action before the Delaware Tax Appeal Board on February 14, 1997. Hoechst Celanese Corporation ("petitioner") was present in the person of Ms. Effie Laurie and was represented by John S. McDaniel, Esquire; Elaine C. Reilly, Esquire; and Paul H. Frankel, Esquire. The Director of Revenue ("Director") was represented by Jos. Patrick Hurley, Deputy Attorney General. Prior to opening statements, a motion to sequester witnesses was made and denied and a stipulation of facts was received into evidence. The Board then heard testimony on behalf of the petitioner from two expert witnesses, Prof. Richard Pomp, and Michael H. Lippman. William Remington, the present Revenue Director, testified on behalf of the respondent.

* * *

FINDINGS OF FACT

The parties have agreed to certain stipulated facts. In addition to those facts, the Board makes the following

factual findings based upon the testimony offered and the exhibits presented.

1) The original return prepared in accordance with the instructions to Form 1100 for the year 1989 was correct and in accordance with Delaware law. The amended return which allocated the economic gain from the sale of the Delaware plant to Delaware, allocated the economic gain from the sale of non-Delaware plants outside of Delaware and apportioned all of the income from recapture of all of the plants, has no basis for such treatment in the Delaware Corporation Income Tax Law.

2) Petitioner had gross receipts from sales and other income from Delaware sources totaling $22,986,876 in 1989. See Ex.C., page 2, Sch. 3-D, line 5.

3) The depreciation deduction attributable to the petitioner's New Castle, Delaware plant produced tax benefits of $118,664 in Delaware, and using average tax rates, tax benefits of $1,845,796 in other states totaling $1,964,400. The total tax paid on the recapture income from the plant, if Delaware allocates all the income to it, and the other states apportion it, is $1,510, 654, leaving an unmatched tax benefit of $453,746 in the taxpayer's favor. See Stip. of Facts, 14, and 18.

4) The total tax due to Delaware on all income on the amended return is $406,909, which is $113,841 less than the value of the depreciation deductions attributable to plants located outside Delaware and claimed against Delaware income in earlier years. See Stipu. of Facts, paragraph 19, and Ex D, Line 13, Col. C.

5) Delaware's statutory scheme first allocates income, whether business or non-business, to the state

where the asset is geographically located or used; the remaining income is then apportioned according to a standard three factor formula. This scheme is different from the general approach used by other states under which they generally first determine the business income of a unitary business and then apportion it, while allocating non-business income according to geographic rules similar to Delaware's.

6) Pomp is of the opinion that the Delaware statutory rules for assigning income in a case involving an event that is unusual in the life of a business produce an inappropriate and improper result.

7) Pomp says this result flows from the Delaware rules which allocate the income in question instead of apportioning it, as did some 33 other states.

8) The specific inappropriate results are:

a) it produces a disproportionate assignment of income;

b) it fails to value the plant as a part of an integrated manufacturing operation; and

c) it results in discrimination because 187% of the gain from the sale of the Delaware plant is being taxed.

9) The improper result caused by the clash between Delaware's allocation rule and the national consensus of formulary apportionment should in Pomp's opinion be cured by the exercise of the discretion given the Director in section 1903.

10) This discretion should be used according to Pomp to remedy what he sees as a disproportionate assignment

of income regardless of whether or not it exceeds constitutional limitations. Pomp is of the opinion that there may well be a constitutional violation.

11) Pomp's opinion is based solely on a separate analysis of the sale of Delaware plant and includes only the treatment of that single item of gain by Delaware and the thirty three other states. Pomp accounted for the sale separately, as a discrete item of income, and did not analyze the taxpayer's entire income or the effect the Delaware statutes had on the overall assignment of a portion of the taxpayer's total income to Delaware. Pomp in fact rejects that kind of analysis as irrelevant and beside the point. For instance, Pomp's analysis does not factor in the allocation of some $77.9 million of income to states outside Delaware when concluding that Delaware disproportionately assigned income for tax purposes. To illustrate by using Pomp's pie example, Pomp focussed only on one slice of the income pie, as if it were the entire pie – *i.e.*, the income from the sale of the Delaware plant – rather than on the numerous other slices of pie making up the taxpayer's entire income.

12) No proof was offered, and Pomp's analysis did not attempt, to show the exact amount of income attributable to Delaware from all the petitioner's business activities in Delaware.

13) The transaction giving rise to the gain is not such an unusual event that the Delaware legislature did not anticipate it and specifically provide for its treatment.

14) Under the existing rules, gain from the sale of Delaware real and tangible personal property will always be subject to tax at 100% by Delaware. Gain from the sale

of Delaware real and tangible personal property that is business income will always be apportioned by other states in a fashion that is designed to tax all of a corporation's business income. Therefore, under facts similar to this case, tax approaching 200% on the gain from the sale of a Delaware business asset will always occur.

15) In 1989, the year for which petitioner requested relief, over 1000 corporate tax returns allocated gains and losses from the sale of real and depreciable tangible property. The approximate amount allocated outside of the state was $6.2 billion in gains and $.5 billion in losses. The approximate amount allocated to Delaware were $30 million in gains and $.5 million in losses. Each of these over 1000 returns were taxed according to the statutes without the application of the relief provision.

16) Lippman in his report and testimony limited his analysis to principles of economic accounting. He, as Pomp before him, looked in a narrow sense at only the acquisition, operation and disposition of the Delaware property. In his opinion the tax on the recapture income should be limited to the tax benefit derived in Delaware from the depreciation claimed on the plant. Lippman did not offer anything on the issue of the division of corporate income for purpose of state taxation, and he did not consider the application of the concept of apportionment or allocation. Lippman's opinion did not consider the depreciation claimed in earlier years from plants located outside Delaware against Delaware income. See Stip. of Facts #19. The tax saved which Lippman ignored equaled some $520,750.

17) Nor did Lippman address the discrepancy in the taxpayer's favor in total tax benefit derived from the depreciation claimed from the Delaware plant in all states, and the total tax paid on recapture gain, even if Delaware allocated all of the recapture gain to itself.

18) In contrast, Remington looked at the taxpayer's entire net income, not just the income attributable to the sale of the plant in deciding not to exercise discretion and in his opinion the tax assigned to Delaware was fair. In addition, concerns of fairness to other similarly situated taxpayers, certainty in application of the statutes, and concerns that granting relief in a case occurring as often as this one would require granting relief in many similar cases and imposing additional tax in even more cases, and would effectively alter the terms of the statute, entered into his decision.

19) This is the first case in which the Board has been called upon to review the Director's decision not to exercise discretion under the provisions of 1903(a).

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